HOUSE OF COMMONS
CANADA

The Future Starts Now

A Study on the Financial Services Sector in Canada

Maurizio Bevilacqua
Chairman
Standing Committee on Finance
December 1998

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Report of the Standing Committee on Finance

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STANDING COMMITTEE ON FINANCE

NOTE

It was agreed That the following text appear on the first page of the 12th Report of the Standing Committee on Finance:

First Report / Preliminary Report

The following motion was adopted unanimously in the House of Commons on October 2, 1998:

> That the Standing Committee on Finance be allowed to travel across Canada, from October 4 to November 10, 1998, in relation to its prebudget consultations and its consultations on the recommendations of the Task Force Report on the Future of the Canadian Financial Services Sector and that the necessary staff do accompany the committee. (Journals, October 2, 1998)

Further to the adoption of this motion, the Chief Government Whip made the following statement in the House of Commons, reflecting an agreement reached by the whips of all parties:

> "The committee will table a...*preliminary report* on its examination of what is commonly known as the MacKay report. That examination will continue throughout February 1999, with hearings to be held here in Ottawa. A *final report* on the MacKay report will then be prepared for tabling in March 1999." (Hansard, October 2, 1998)

MINUTES OF PROCEEDINGS (Extract)

MONDAY, DECEMBER 7, 1998
(Meeting No. 165)

> *It was agreed That a note be printed on the first page of the 12th Report of the Standing Committee on Finance, reflecting an agreement made in the House of Commons on October 2, 1998, that a preliminary report be tabled in December 1998 and that a final report be tabled in March 1999.*

Jacques Lahaie Roxanne Enman
Clerks of the Committee

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OTHER MEMBERS WHO PARTICIPATED

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CLERKS OF THE COMMITTEE

Jacques Lahaie　　Roxanne Enman

RESEARCHERS TO THE COMMITTEE

(Parliamentary Research Branch)

Richard Domingue
Marion Wrobel

(TGC Inc.)

Joseph Mayer, consultant

THE STANDING COMMITTEE ON FINANCE

has the honour to present its

TWELFTH REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied Report of the Task Force on the Future of the Canadian Financial Services Sector and has agreed to report the following:

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CHAIRMAN'S MESSAGE

As we approach the 21st century, Canadians are being called upon to deal with rapid changes at every level. Social, political, demographic and technological changes are shaking the foundations of long-held beliefs that have defined our society throughout the current century.

Various applications of new technology are revolutionizing every aspect of the industrialized world's economy, from resource extraction, to manufacturing, to the service sector.

Communications technology, especially telecommunications, has also been fundamentally changed by the information revolution, and this is having a deeply felt impact on our society. Indeed, the transformations in information technology and communications technology are the cornerstones of globalization. We now live in a world where you can instantly reach a person almost anywhere on the planet by telephone, by fax or over the Internet. Billions of people around the world watch the same news events at the same time. The global village is now a reality.

Globalization: The New Reality

To an ever increasing degree, governments, corporations and individuals are making decisions in the context of a global market. Men and women are building careers that include periods of work in Southeast Asia, Europe and North America. Around the globe, financial markets are woven together into a seamless web, one where trading in Tokyo, Taipei and Hong Kong influence London, Paris and Frankfurt which in turn help shape trends in New York, Toronto and Chicago. Billions of dollars fly through the atmosphere at the touch of a computer key.

With the support of information and communications technology, corporations run truly global operations. In many emerging sectors, senior management of a firm can be located in London or New York or Montreal while the firm's workers are in Singapore or Belfast or Moncton, effortlessly serving customers in Stuttgart or Osaka or Seattle. The new world economy has redefined time and space.

The global economy is a reality. It offers new opportunities and, as we have seen recently in Japan, East Asia and Russia, it also presents new risks. Everyone, both individuals and corporations, are doing their best to adapt to globalization. Therefore, it should surprise no one that financial service sectors around the world are changing in order to adapt as well. Canadian banks, insurance companies, mutual funds, credit unions, trust companies, caisses populaires and other financial service providers are adopting a variety of strategies to ensure their long-term growth in this new environment. These strategies can include the introduction of new services, an increase in the use of new technology, acquisitions across sectors, or mergers between players within the same sector.

The Government of Canada has a responsibility to ensure that Canadians continue to benefit from a sound financial service sector. Its major role is to safeguard the public interest and see that Canadian citizens are able to gain access to financial services. And it also has a duty to ensure that the financial services industry is able to take full advantage of new opportunities around the world, and compete with foreign rivals. After all, we should be mindful of the fact that this key sector directly employs over 550,000 Canadians in jobs which are increasingly highly skilled and well paid.

The Challenge Facing the Committee

Clearly, this has been the principal challenge facing our Committee during our hearings on the Task Force Report on the Future of Canada's Financial Services Sector, also known as the MacKay Report. The Committee's goal was to chart a direction for the future of this sector that strikes a balance between the expectations of the financial service providers and the needs of their customers, including individual Canadians, small and medium-sized businesses, and others.

The MacKay Task Force Report was the opening statement in an important national dialogue which must take place between Canadians, their elected representatives and the financial services sector. Our report, the product of intensive work by the members of the Finance Committee, is a response to the MacKay Report.

The Finance Committee's report presents what we heard from Canadians in their reaction to the MacKay Report. We heard from firms and individuals that look toward the future full of confidence; witnesses who see the MacKay Task Force Report as a blueprint for a more open system that will enable established firms to maintain their strong positions while allowing new players to emerge and prosper.

The Committee also heard from groups, companies and people who have serious misgivings about globalization and who are concerned about being left behind by the transformation of the financial sector, either as the result of consolidation within the sector, or corporate lay-offs, or the increasing reliance on technology at the expense of traditional modes of service delivery. Still others expressed strong opinions about being excluded from the system, either through their inability to secure basic services or financing for commercial ventures. Furthermore, some believe the result of enacting the MacKay recommendations will include a new level of onerous and rigid bureaucratic controls.

While there was disagreement on these and other points, there was also a surprising level of consensus of a number of important issues. For example, the Canadian system is respected around the world as one of unparalleled soundness, safety, efficiency and effectiveness. We have a payments system that is the envy of the world.

What all this amounts to is a deeply rooted connection between customers and their financial service providers. It is clear that, for many Canadians, banks and other financial institutions are, in fact, an important part of their everyday lives. There is no doubt that this bond is real for millions of Canadians.

The Goal: Building a Modern Financial Services Sector

As a Parliamentary body providing the government with input on an important matter of public policy, it is incumbent on us all to recommend actions that are in the public interest. Our recommendations reflect that commitment.

We cannot predict the future, but we can help shape it. In the opinion of this Committee, the concept of "the public interest" must be defined by a long-term vision. In the interest of serving Canadians, we must try to gain some sense of what the world of financial services will look like when our children are establishing their families and building their careers. The world is changing so rapidly thus, trying to stop the clock is unrealistic.

Members of this Committee recognized that they had the responsibility of using their judgment to carefully weigh the divergent opinions we heard.

We have approached this exercise in a clear-headed manner, focussing on the goal we all share: building a modern financial services sector that serves the interests of all Canadians. We believe our report provides the government with a realistic plan to achieve this important objective.

On behalf of the Committee, I would like to thank the many individuals and organizations that took part in our cross-country consultations. Through written submissions, Committee appearances and townhall meetings organized in various ridings, these Canadians provided the Committee with the full spectrum of opinion and analysis that enabled us to conduct this study.

I would also like to express my gratitude to my fellow Committee members for their tireless efforts that they invested in this process. This year the Committee simultaneously undertook two major studies, the Pre-Budget Consultations and the Study of the Task Force on the Future of the Canadian Financial Services Sector. This was truly a demonstration of the dedication of our Members to the public consultation process. We all feel that it is important for Canadians to be heard on such vital matters.

The Members, however, could not undertake their work without the support of our staff. The Committee wishes to thank our clerks, Jacques Lahaie and Roxanne Enman for their contributions. We also thank Lise Tierney and Denyse Croteau from Committees Branch, as well as the interpreters, sound technicians and other members of the House of Commons staff.

The Committee also wishes to thank our research staff, Richard Domingue and Marion G. Wrobel of the Parliamentary Research Branch. We thank Joseph Mayer and Robert Kermode for their editorial services. And we are grateful to the production team, the translators and everyone else who worked on the report to ensure its quality. In addition I am grateful for the assistance of Julie Cusson.

Finally, I wish to thank my Special Assistant, Jennifer Demers for her hard work and dedication these past few months.

Maurizio Bevilacqua
Chairman

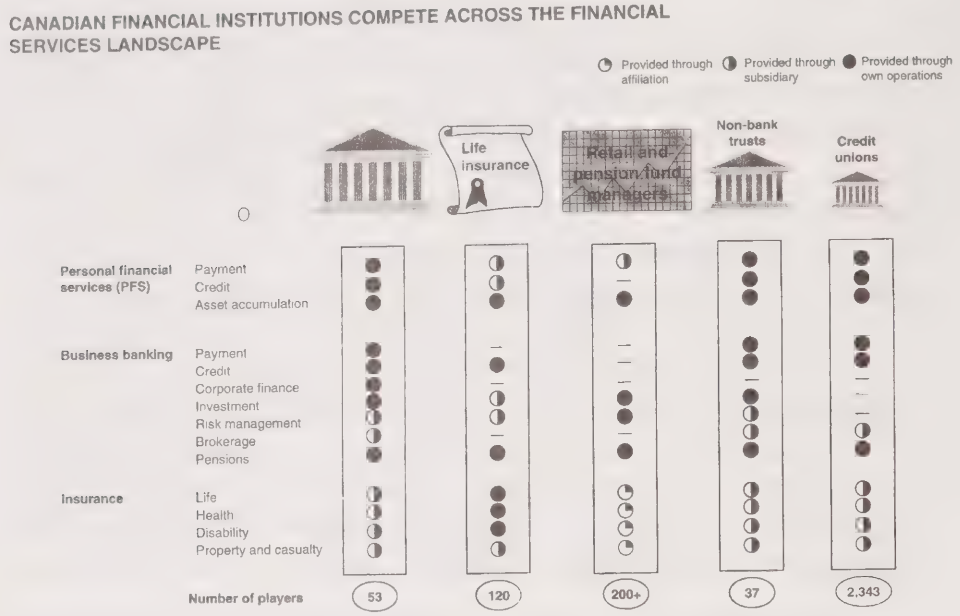
CHAPTER 1: THE 1990s: STEPS IN THE RIGHT DIRECTION

In 1992, the federal government made significant changes to the way the financial services sector operates in Canada. These reforms virtually put at end to the "four pillar" characterization of the financial services sector. After 1992, any federally-chartered financial institution could provide almost any financial service. In part this was achieved by enhancing the in-house powers of institutions. It was primarily achieved, however, by allowing one type of institution to own a subsidiary in another financial field. As a result, we today see banks owning securities dealers, trust companies and insurance companies. Insurance companies own trust companies and banks. Vancouver City Savings, a large British Columbia credit union, owns Citizens Bank. Trimark Trust is owned by a mutual fund company.[1] Thus the industry is very different than it was prior to 1992, largely as a result of these legislative changes.

The financial sector is also very different because of economic and financial events. The independent trust company sector has virtually disappeared, with only Canada Trust remaining as a significant force in the industry. While a number of trust companies were purchased by the banks, the demise of the sector had its origins in the inability of these firms to survive, and compete with other institutions, in a changing world. The 1992 changes that were intended to allow them to better compete with banks, in many ways came too late.

1 Although this particular development is relatively recent, it did not require federal legislative changes to implement it.

The Collapse of the Pillars



Source Exhibit 2-18 McKinsey & Company

The government recognized that, in a rapidly changing world, reforms need to be ongoing. Instead of reviewing the legislative framework for banks every ten years, the government decided to undertake such a review every five years, starting in 1997, and do so for the entire financial sector simultaneously. In 1995, in response to the earlier failures of several trust companies and life insurance companies, the Secretary of State (International Financial Institutions) published a paper entitled "Enhancing the Safety and Soundness of the Canadian Financial System." It dealt primarily with measures to reduce risks, protect consumers and enhance government oversight. That paper and the resultant legislation were motivated by a desire to make the financial system more secure. As a result of that process, a mandate for the Office of the Superintendent of Financial Institutions (OSFI) was defined and the Canada Deposit Insurance Corporation Act (CDIC Act) was amended to permit bylaws establishing premiums based on risk assessment.

In 1996, a white paper entitled "1997 Review of Financial Sector Legislation: Proposals for Change" was published and became the basis for the legislative changes found in Bill C-82. The

point of that examination was to determine whether the framework set out in 1992 continued to be adequate, and to establish if those earlier changes were achieving their intended goals.

The white paper was the result of consultations with industry stakeholders that started in 1995. One of the more significant results was the announcement that the federal government intended to extend the demutualization option to large life insurance companies as well as small ones—draft regulations for such conversions were published in August 1998, and legislation tabled on November 30, 1998. Yet it was clear to the government that the white paper, and the process that led up to it, could not adequately deal with some of the very significant forces of change that were shaping the global financial environment, and hence affecting the ability of Canadian financial institutions to adapt to economic, technological and demographic events. Profound reforms would likely be needed if Canada were to enjoy the benefits of a world-class financial services sector.

As a consequence, the government established a Payments System Advisory Committee to examine the payments system. It was directed to provide input into the work of the newly established Task Force on the Future of the Canadian Financial Services Sector, which was given the mandate of studying all aspects of the industry. It is the Report of that Task Force that was the purpose of our own Committee study, and forms the subject matter of this Report.

EVOLUTION OF THE FINANCIAL SERVICES SECTOR

As noted above, an entire pillar of the financial services sector (i.e. the independent trust companies sector) has virtually disappeared in less than a decade. This change, dramatic as it may seem, is nevertheless only one of the many other developments that have occurred, and insignificant when compared to what is likely to happen in even the near future.

While total deposits retain an important place among household financial assets, their growth relative to overall assets has been stagnant and is expected to decline over time. (This information bullet and all others are drawn from the background documentation prepared for the Task Force on the Future of the Canadian Financial Services Sector.)

Canadians are today buying financial services that are very different from the ones they purchased only a few years ago. To underscore this change, we need only look at the dramatic growth of the mutual funds industry. Canadians have traditionally been characterized as cautious savers. We placed our savings in bank accounts and guaranteed investment certificates, comforted by the

Over the last 20 years, while the percentage of total household financial assets in deposits has dropped from 31 percent to 25 percent, the percentage in mutual funds has risen from 1 percent to 14 percent.

fact that they were protected by a system of deposit insurance. We bought life insurance. We did not take risks. Yet from the end of 1991 to the middle of 1998, the net assets of mutual funds in Canada grew from $50 billion to $323 billion. Deposits, on the other hand, have stopped growing and are slowly declining from a peak of about $450 billion. The fact that mutual funds are poised to exceed deposits[2] within a few years demonstrates some of the rapid changes that are taking place. We clearly no longer save via traditional products and financial institutions. This not only provides evidence of changing consumer demands, it has very real implications for institutions that have traditionally raised funds through deposits. The loans and investments that have traditionally been financed via deposits must now be financed in different ways.

Canadians are being served in different ways and are being offered products by institutions that did not serve Canadians only a short while ago, such as ING Direct, Citizens Bank, MBNA, mbanx, and Wells Fargo. We are engaging in financial transactions over the telephone and via the internet, and have overwhelmingly embraced debit cards as a means of payment. It is these developments, driven by consumer demand and a global financial marketplace, that define the new financial services environment. Financial institutions are also introducing innovative technologies to deliver their services, and consumers have only seen a glimpse of what the future holds in this regard.

In the 1980s, when the government was considering ways to enhance the competition that would face the large Canadian banks, it envisaged other institutions that would largely look like our own banks, Schedule II foreign bank subsidiaries and domestic trust companies. Today, however, the new competition that our banks face comes from institutions that do not want to look like the traditional Canadian bank. Thus we now see banks that have no branches, we are banking in supermarkets, we are obtaining credit cards from foreign institutions that do nothing but issue such cards and that dwarf the credit card operations of our own banks. And we are obtaining small business loans from a California-based bank with no physical presence in this country. We buy insurance over the phone, we bank over the internet and we are increasingly becoming a cashless society. Paycheques are automatically

2 Although the amounts invested in mutual funds do not exceed total bank deposits, they now exceed total personal deposits in the banks.

deposited into our accounts and monthly bills are automatically debited from those accounts. The world of 1998 is far different from that of 1992. Undoubtedly, the year 2002 will be very different again.

The other dominant development in the financial services sector is the wave of consolidation that is taking place globally, especially in the United States, but also in Europe. In Europe the trend to mergers is being driven by a desire to cut costs and take advantage of the upcoming monetary union. In the United States it is largely a response to legislative reform that is finally allowing the creation of national banks, as is already the case in Canada. BankAmerica, for example, has engaged in a series of amalgamations that give it coast-to-coast operations and total assets that would be about 75% greater than that of a combined Royal Bank-Bank of Montreal. Yet it still has a presence in less than one-half of American states. The other American merger that stands out is the one between Citicorp (a bank) and Travelers (a non-bank financial institution). This proposal, which pushes the limits of current American legislation, created a financial conglomerate like those that already characterize the Canadian banking industry, albeit much larger in size.

This trend to acquisition and amalgamation also exists in Canada. Since 1992, Canadian financial institutions have truly become financial conglomerates. In 1997, Great-West Life outbid Royal Bank of Canada for the acquisition of London Life. More dramatically though, some Canadian banks would also like to participate in this merger trend—the Royal Bank of Canada proposed a merger with the Bank of Montreal in January 1998, followed by an announcement in April that the Canadian Imperial Bank of Commerce intended to amalgamate with the Toronto-Dominion Bank. These mergers are not the subject of the Task Force Report, and not the subject of this Committee Report. Nevertheless, the shape of the financial services sector that will arise after the Task Force Report is debated and acted upon is the environment in which these and/or future merger proposals will be evaluated. Pressures to consolidate and restructure will continue to exist in Canada and around the world. What we will examine here are the measures that the Task Force recommends to facilitate consolidation and the method by which the Task Force proposes to evaluate such transactions, to ensure that they are in the public interest.

WHY IS THE TASK FORCE REPORT SO IMPORTANT?

[T]he MacKay Report . . . is an excellent report. It's very well balanced. Sometimes in reading it I thought they were trying to please everybody in the financial community. That's a very difficult thing to do. I think they did an excellent job.

Liam Hopkins (Executive Director, IFC Vancouver)

The Task Force Report will likely stand out as one of the most important works on financial services ever produced in Canada. Like the Porter Commission three decades earlier, it will redefine the financial sector. This Task Force Report does not deal with the proposed bank mergers. The Task Force Report is important because it deals with a vast, important and ever-changing industry that is vital to the well-being of Canadians and the proper functioning of our economy. This industry transcends banking and individual banks.

As someone who works in the policy environment and has read many reports over many years of this work, I must say we found this report to be one of the better ones. It was balanced, clear and well written, so I'd like that noted by you if you would.

Mr. Peter Nares (Executive Director, Self Employment Development Initiatives)

The financial services sector is in many ways an industry like no other. Like any other industry, it serves customers by providing the goods and services that are demanded. Canadian firms participate in the industry and wealth and jobs are created. More than 550,000 Canadians are directly employed in the sector and it is responsible for 5% of our GDP. It contributes 20% of federal corporate income taxes and pays a total of $8.5 billion in taxes annually. And it is a major export industry, with more than 30% of bank and life insurance revenues coming from outside Canada. In the case of some institutions, the export orientation is much greater. The Bank of Montreal gets 58% of its revenues from abroad while the life insurance company Manulife earns 55% of its income outside Canada. Newcourt Credit, one of the fastest growing domestic financial institutions, is now originating about two-thirds of its loans outside Canada.

More than 50 percent of all Canadian corporate bonds are issued abroad today as are 20 percent of all Canadian government-issued bonds.

According to **The Banker** magazine, Canadian banks are very much globally oriented. If banks are ranked by the proportion of their assets that are non-domestic, Canadian banks rank 20th (CIBC), 21st (Bank of Montreal), 27th (Scotiabank) and 39th (Royal) amongst world banks. Both CIBC and the Bank of Montreal have 44% of their assets overseas, and the Bank of Montreal earns 58% of its earnings overseas. Scotiabank earns 49% of its income overseas, while Royal earns 28% abroad.

By this measure, the Bank of Montreal and CIBC are more global than Chase Manhattan, Bank of Tokyo, and ING.

The export orientation of Canada's financial sector demonstrates that customers far afield can be served from Canada. But we are beginning to recognize that institutions from far afield can also serve Canadians.

The Greater Toronto Area (GTA), which is the primary Canadian financial centre with over 165,000 direct financial sector jobs in 1995,[3] has the potential of becoming a North American regional financial centre. After New York and San Francisco, the GTA has the third highest concentration of financial services in North America. On the other hand it could easily find itself with a much diminished role and much diminished employment, as over one-half the financial services jobs in the GTA could move elsewhere.

One vision of Canada would have us at the table as a major North American financial centre (Canadian-controlled and Canadian-headquartered) that is influential in global financial affairs. The other would see us slip further from the top tier and become a gradually declining influence in financial affairs, and indeed in world affairs. Canada might remain a healthy domestic financial marketplace, but it would not be a global financial force.

Mr. A. Charles Baillie (President and Chief Executive Officer, Toronto Dominion Bank)

The Boston Consulting Group analyzed the various categories of jobs in the financial services sector to see which ones are mobile and might, therefore, migrate away from the GTA, and even away from Canada. Jobs were classified as either traded (i.e. those which could be located elsewhere) or non-traded (i.e. those which, at present, must be performed locally). Fifty-five per cent of jobs were classified as traded while 45% were non traded.[4]

Of the traded jobs, one-third were considered well anchored in the GTA whereas the other two-thirds were potentially mobile. Well-anchored jobs include the following, among others:

- Bank headquarters functions
- Some corporate banking functions
- Trading in Canadian-dollar based products
- Investment functions related to insurance.

The jobs related to bank headquarters are based on the assumption that Canadian control is maintained.

The two-thirds of traded jobs that are potentially mobile include the following:

- Back office functions, especially computer centres, processing centres and call centres

3 Boston Consulting Group, *Financial Services at the Crossroads*, January 1997.

4 Ibid. p.24.

- Most investment bank functions
- Life and health insurance business.

Forty-five per cent of all jobs are considered to be in the non-traded category. Technology is increasingly affecting the mobility of jobs, however. Of those non-traded jobs, 40% will evolve into traded and mobile jobs. These evolving functions include:

- Retail sales functions handled over the phone or the internet
- Processing centres.

Those functions that are likely to remain non traded in the future include:

- Personal advisory services
- The retail bank network
- Face-to-face financial planning.

These non-traded functions represent just over one-quarter of total employment.

It is technology that is responsible for the changing nature of work and the location of employment opportunities. Declining telecommunications and computing costs, combined with developments in imaging technology, mean that job functions that in the past were undertaken at the local level could now migrate to a centralized location. But these developments also mean that job functions that are now performed near the Canadian headquarters of financial institutions, could also migrate elsewhere, even outside Canada. These jobs will only stay in Canada if the financial sector is sufficiently competitive so that it would be efficient to locate those jobs here.

Canadians have benefited from the fact that our financial institutions have global ambitions, and in the process created domestic jobs to serve world markets. There is no guarantee that this will continue. Virtually all factors of production are becoming increasingly mobile. To attract and keep them requires a framework that allows financial institutions to be competitive.

The financial services sector is, therefore, a very important contributor to the economy in its own right. But its greatest importance comes from the special role it plays in the economy.

Unlike other sectors, it is an extremely vital component of virtually all economic transactions. Because its effects are so pervasive, the financial sector influences the functioning of the economy in ways that no other industry can. It truly determines whether the economy runs smoothly and efficiently. It does this through the process of financial intermediation. Those who have funds to save, do not have to find credit worthy borrowers. Financial institutions do that for them. This not only reduces substantially the transactions costs associated with saving and borrowing, it reduces substantially the risks that savers face. They do not need to be able to assess the risk of individual borrowers or individual investment projects — specialized institutions do that for them. And because this task is provided by specialists, those institutions are able to take advantage of economies of scale and scope.

The other important function of the financial sector is the provision of an efficient payments system, and in Canada our payments system is the envy of the world. With safe and efficient transactions media, economic exchange is encouraged. This allows economic participants to specialize and hence maximize the returns from their activities.

For Canada to enjoy a thriving economy, it needs a financial services sector that is stable and sound, that is efficient and competitive, that is innovative, and that offers Canadians a wide range of choices. It must adapt as the world around it changes. In short, we need a world class financial services sector.

THE IMPACT OF TECHNOLOGY

Rapid changes are affecting the financial sector. **Technology** is one of the driving forces behind this. With the rapid decline in the costs of telecommunications and data processing, financial services can now be provided in ways and in places that were not possible before, and that may be obsolete and uneconomic tomorrow. Transactions can be completed with great speed. These changes are causing some institutions to restructure themselves quite dramatically. They are providing services centrally rather than locally as they did previously. Some institutions are now outsourcing certain activities. Some are taking on new activities, some are abandoning services in which they cannot compete, and

No doubt, the power of computers will continue to escalate as the price continues to drop. In 1982, microprocessors with a computing capacity of one million instructions per second (i.e., one MIP) cost almost $1,000. Today, one MIP costs about $1.30; within a decade, we estimate it will cost about $0.001.

Leading global wholesale banks, on average, develop a new product every week. Most leading investment banks have a dedicated group or groups of trained mathematicians and statisticians who continuously focus on developing product bundles for both issuers and investors.

others are entering into joint ventures. All of these changes are being driven by the quest to reduce costs. And the need to reduce costs is being driven by the appearance of new competition.

The other impact of technological change has been the introduction of new financial products, most evident in the payments system but also in products that are designed to reduce risk and enhance opportunities to gain better returns on savings. Derivatives trading, debit cards and stored value cards are only a few examples. What is striking about these changes is the fact that they do not benefit just large institutions or wealthy individuals. Typical Canadian families receive tangible benefits as well. For example, Canadians who have no room to make additional foreign property investments in their RRSPs may buy mutual funds whose return is linked to certain American stock indexes. This helps to circumvent the effect of the 20% foreign property limit on individual investors. Canadians who want the protection of a Guaranteed Investment Certificate (GIC) but wish to take on some of the risks of equity investments can purchase a GIC whose return is linked to certain Canadian stock indexes. In both cases, it is the development of derivatives that allows this to take place.[5]

Advanced data analysis software, for example, has allowed financial institutions to develop sophisticated, highly predictive database marketing programs. These have been implemented successfully by high performing credit card companies such as MBNA to target high-value customers more effectively in both their domestic and their foreign markets.

Changes in "intellectual" technology are also changing the industry. With the development of credit scoring techniques to evaluate risk, institutions are able to quickly assess loan applications at little cost. The Internet application and approval process established by mbanx is able to approve a mortgage application in 30 seconds, eighty per cent of the time. The administrative costs of loans that can be evaluated this way are dramatically reduced. Institutions can now profitably deliver small loans that they could not offer in the past.

New intellectual technology and new marketing approaches also enable distant lenders such as Wells Fargo to serve the Canadian market. This has the effect of dramatically opening up the domestic market and satisfying consumers' desires for more choice, independently of government initiatives.

5 Although derivatives allow individual investors to take on new types of risk, they do pay for this through slightly lower rates of return than they could earn via direct investments.

CHANGING DEMOGRAPHICS

A further trend that is affecting the development of the industry is **demographic change**. The population is ageing on average. Moreover, the age structure of the population is such that those for whom savings accumulation is of paramount concern are becoming more important relative to those for whom access to credit is of most concern. Financial institutions are increasingly looking upon households not just as customers who need credit, but as customers who need help in managing their wealth. They are increasingly trying to develop a holistic relationship with their best customers.

Some 9.8 million Canadians, or about one third of our population, dominate the market for retail financial services.

The focus on wealth management is the result of several developments in addition the ageing of the population. There is a large transfer of wealth that is taking place from one generation to another. Such lump-sum transfers need to be managed wisely. Finally, Canadians are working for themselves in increasing numbers. Self-employment means self provision of health and retirement benefits. Servicing these Canadians presents a new set of challenges for our financial institutions and a new focus in terms of the services they offer.

The boomer population will soon inherit an unprecedented amount of wealth from their parents. One estimate is that $1 trillion of wealth will transfer between generations.

Self-employment represents 17.9 percent of Canada's total employment in 1997, up from 13.3 percent in 1986. Eleven percent of employed Canadians report that they work primarily from their home. Almost half of working Canadians (48 percent) say they work out of their home regularly or some of the time.

When coupled with the emergence of a low inflation/low interest rate environment, these trends have led to a substantial shift in the products that Canadians want. They want better rates of return, and because of their increasingly long-term investment horizons, they are willing to take on more risk.

GLOBALIZATION OF MARKETS

Technology and demographic change are factors that are largely beyond the control of government. Governments have, however, increased access to domestic markets by non-resident institutions through a variety of international agreements. When coupled with the transformation of centrally planned economies into open market economies, we see a dramatic change in the opportunities available to commercial and financial enterprises. Most nations are opening up their domestic markets to non-resident institutions in anticipation of reciprocal actions on the part of other countries, leading to a very real **globalization** of markets. These measures increase competition locally but also

assist commercial firms in enjoying seamless access to financial services across the world. Scotiabank is a prime Canadian example of a financial institution that has followed its customers abroad, making it the most internationally focussed of the Canadian banks, one that takes pride in noting that it was in Kingston, Jamaica before it was in Toronto.

Over time, the relative positions of different institutional types has changed. Banks used to be the dominant financial intermediaries. Today, their proportionate share of financial assets is far lower, having lost market share to a variety of others, who have come and gone over time.

WHAT DOES THE COMMITTEE SEEK TO ACHIEVE?

The House of Commons Standing Committee on Finance is undertaking this examination to consider ways in which the recommendations of the Task Force on the Future of the Canadian Financial Services Sector can contribute to the establishment of a world-class financial sector in Canada. We must recognize clearly that the role of government is limited. As the Task Force Discussion Paper noted, "Parliament cannot legislate that Canadian financial institutions must provide world-class services. Parliament cannot legislate that our small business sector will flourish, or that Canadians will remain at the cutting edge in the development of knowledge-based industries."[6] What it can guarantee is a commitment to sound and efficient regulation, coupled with an environment that allows flexibility, innovation, competition and the opportunity for financial institutions to profitably serve Canadians.

The Committee recognizes that the future brings with it both opportunities and challenges. We see some of that today. While we cannot, and should not, hide from the challenges, we must also ensure that we do not fail to seize the opportunities. That is really what the Committee seeks to achieve; to create a legislative and regulatory environment in which the financial sector can meet and beat the challenges it faces, in which it can seize new opportunities and in which all Canadians can enjoy the benefits of a world-class financial system.

6 Task Force on the Future of the Canadian Financial Services Sector, Discussion Paper, June 1997, p.5.

Future review, whether in the year 2002 or earlier, will be decisive. If successful, it will meet the challenges of globalization, innovative technologies, the promotion of a progressive financial services sector, and the protection of consumers.

Meeting the International Challenge: We wish to ensure that Canadians do not miss out on the varied and beneficial developments that are taking place around the world. This includes not only Canadians as consumers of financial institutions but Canadians as providers of financial services as well. New products and institutions will threaten the market share of existing Canadian firms. At the same time however, the government should not block efforts by Canadian institutions to become internationally competitive — indeed, the Government of Canada should encourage and facilitate such efforts. While the Committee does not believe that we should promote bigness simply for the purposes of having larger institutions, we should not let a fear of bigness stand in the way of the ability of our financial institutions to take on new opportunities, provided they are in the public interest. Rather, the government should put in place a rigorous framework to assess the effects of consolidation, and to ensure that the market in Canada is subject to as much competition as possible. Only in this way can we guarantee that the industry will be able to meet the globalization challenge and that Canadian consumers of financial services will have access to the best that the global financial sector can offer.

Meeting the Technological Challenge: Technology is helping to drive financial change. Not only can we now access financial services in ways that did not exist before, for example via virtual banking, we can also purchase products that were not previously available. Technology offers an opportunity for residents in rural and remote communities to have access to better financial services than they did in the past, albeit in different ways.

Technology can also bring challenges. As institutions find ways to use technology to cut costs, competitive pressures cause institutions to abandon traditional face-to-face contact. Unfortunately, not all Canadians can adapt rapidly to the new technological environment. The challenge is to ensure that all customers are served during this transition period, as we move from one paradigm to another.

Growing the Economy through the Financial Services Sector: For the Canadian economy to prosper, it needs access to capital and a variety of financial services. Generally, the financial sector provides these services well. There are, however, certain sectors that are not so well served. Even worse, those sectors that are perceived to be poorly served are the ones that have the potential to offer most to the economy, the small business sector and the knowledge-based economy.

It is vital that the financial services sector find ways to serve these important parts of the Canadian economy. Reform of the sector should be of benefit to both Small and Medium-Sized Enterprises (SMEs) and Knowledge-Based Industries (KBIs). If existing players cannot serve these sectors well, maybe new entrants can, especially if these entrants bring with them new ways of doing business such as new ways of assessing risk or new attitudes to risk. And to the extent that such new entry brings about enhanced competition, it will force incumbent institutions to find better ways to serve their existing clients.

If the financial services sector is to contribute to the functioning of the Canadian economy, the sector must be efficient. Financial services are an input into the production process. The more efficient is this sector, the better will the economy be served. When competition and efficiency are combined, prices will be lower and service quality will be higher.

Achieving a Prosperous and Productive Financial Services Sector: Given the trends in the financial sector, it is sometimes difficult to define the extent of, and the participants in, that sector. Competition increasingly comes from surprising and novel sources. Increasingly it is coming from institutions that are immune to Canadian government regulation.

It is important that the financial sector be flexible enough that it can adapt to the changing needs of Canadians. If the Canadian financial services sector cannot adapt to these changing needs and the changing environment, Canadians and non-Canadians will seek services elsewhere. Not only should the Government of Canada work to ensure that this does not happen, it should actively work to ensure that domestic institutions do not miss similar opportunities to serve markets outside our own.

The future of the financial services sector cannot be predicted. We do not know what new products could be offered in the future and we do not know what kinds of products consumers will want. We do not know how they will be delivered and who, in fact, will offer them. Consequently, the only safe thing to say about the future is that any attempt to impose a rigid model for the financial services sector in the future will likely be counterproductive, both from the point of view of financial institutions and Canadian consumers.

Preserving Confidence, Safety and Soundness: The financial sector, has been and will continue to be heavily regulated when compared to other sectors of the economy. In many respects this regulation is a source of strength as it provides consumers with confidence in the industry. Confidence in the sector is a public good in the sense that it cannot be appropriated by any one firm. It benefits all participants in the sector and thus makes it stronger. Too much regulation, inefficient regulation and inappropriate regulation is a burden, however. Such a burden is either borne by consumers directly via higher costs of services or less choice, or indirectly via an unlevel playing field that penalizes some institutions over others. It is important that the government find the right balance between prudential regulation that enhances the industry and excessive regulation that harms it.

In the following chapters, the Committee provides more details on the four themes contained in the Task Force Report, namely enhancing competition and competitiveness, empowering consumers, improving the regulatory framework and meeting Canadians' expectations, and the recommendations that follow.

CHAPTER 2: THE CHANGING FACE OF THE FINANCIAL SECTOR IN CANADA

Globalization, consolidation of existing firms, the arrival of new Canadian entrants, technological innovations driven by more sophisticated consumers who are demanding better and more convenient delivery modes, and demographic trends are all about to impose dramatic changes on the Canadian financial services sector that were unthinkable just a few years ago. Some of these changes are already noticeable, on both the supply and demand sides. What we are about to see is even more rapid evolution. What will happen to the landscape of Canadian financial institutions is not unique to Canada. Major restructuring is taking place around the world and in Canada. Based on what happened in the last decade, based on what will happen in the years to come, it is difficult to imagine how our collective future will look.

The changes in the relative importance of the various financial institutions can be seen in the following table.

FINANCIAL SECTOR OVERVIEW 1991 AND 1997

Sector	No. of companies		Assets ($ millions)		Capital ($ millions)		Total revenues ($ millions)		Net income ($ millions)		Employees	
	1991	1997	1991	1997	1991	1997	1991	1997	1991	1997	1991	1997
Banks	64	55	611,816	1,224,314	34,782	54,699	63,746	80,468	3,767	7,955	191,596	194,800
Canadian	8	11	553,654	1,132,438	30,733	49,767	58,369	74,893	3,741	7,551	183,996	n.a.
Foreign	56	44	58,162	91,875	4,049	4,932	5,377	5,575	26	404	7,600	n.a.
Trusts	78	34	155,118	55,100	6,365	2,508	15,737	5,602	50	607	36,000	22,900
Credit unions	2,700	2,289	79,858	107,000	5,081	7,096	9,293	7,882	410	582	n.a.	61,600
Life insurance	155	132	200,550	251,361	19,927	30,732	53,120	62,721	n.a.	2,956	65,049	104,271
Canadian	82	46	176,130	225,943	n.a.	26,760	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign	73	86	24,420	25,418	n.a.	3,972	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
P&C insurance	350	216	33,726	53,600	11,036	15,651	16,775	21,760	870	1,960	117,740	37,055
Canadian	198	97	n.a.	n.a.	n.a.	n.a.	6,145	6,953	n.a.	n.a.	n.a.	n.a.
Foreign	152	119	n.a.	n.a.	n.a.	n.a.	10,630	14,807	n.a.	n.a.	n.a.	n.a.
Securities dealers	118	187	26,918	13,280	1,036	2,751	3,579	10,791	262	640	19,324	32,900
Investment funds (called Mutual funds in the 1991-1992 edition)	119	78	49,916	283,200	n.a.	n.a.	n.a.	23,400	n.a.	n.a.	26,641	35,000

Sources: "The Canadian Financial Services Industry; The Year in Review, 1991-1992 and 1997 Editions", The Conference Board of Canada.

i. Globalization

Globalization means increased competition and more choices. It means new opportunities for Canadian firms and households. This increased competition will translate into better quality financial services, more choice and lower prices. Canadian financial institutions have known for years that there are benefits and growth potential in investing abroad. In Canada, new entrants such as Wells Fargo, MBNA, Capital One, and ING Direct have already had an impact on the industry and on consumers. New entrants by way of acquisition (Merrill Lynch buying Midland Walwyn, for example) will also change the face of the industry.

ii. Consolidation

The Task Force views consolidation and industry restructuring as a legitimate strategy for financial firms. Indeed, in some circumstances, it is desirable and the Task Force Report makes numerous recommendations that would facilitate consolidation. It is one way to adapt to changing circumstances and a changing environment.

Of course, this phenomenon is not new. Restructuring and consolidation have always been a feature of the Canadian financial landscape. It was used as a policy tool to respond to the failure of financial institutions. More significantly, however, it was past instances of consolidation that produced our national banks.

There are also more recent examples of this phenomenon. The recent, failed attempt by Royal Bank to acquire London Life, which was finally acquired by Great-West Life, is one striking example. One can also look at the restructuring that took place in the trust industry. At the peak of their influence, between 1988 and 1991, trust companies accounted for about 22 per cent of deposits in Canada. With the failure of a number of large and smaller trust companies in the 1980s and early 1990s, many of which led to acquisitions by banks, there is now only one large independent trust company (Canada Trust), and about 30 much smaller players, compared to 81 trust companies in 1993. Collectively, these companies now have about 9 per cent of deposits.

Mergers are among the most visible and, in consequence, among the most controversial strategies to achieve restructuring goals in the financial services sector. While the actual number of mergers in Canada has declined slightly since 1994, the number of transactions per year from 1993 to the present is considerably higher than in the late 1980s. The Conference Board of Canada reports over 350 mergers in the Canadian financial services sector in the last 10 years.

One could also look at the restructuring that took place in the securities industry when the banks were allowed to enter the business in 1987. Almost all the mid-sized players have

disappeared. In total, there have been over 350 mergers and acquisitions in the Canadian financial services sector in the last 10 years.

iii. New Entrants

The most visible example of new entry into the Canadian financial services sector came about as a result of the 1980 changes to the *Bank Act* that allowed foreign banks to establish subsidiaries in Canada. There are currently 44 of these foreign bank subsidiaries operating in Canada, down from 56 in 1991. Only one, the Hongkong Bank of Canada, has an extensive branch network with a significant share of the market. Overall, these foreign banks now control approximately 10 per cent of domestic assets.[7]

This history of barriers to foreign bank entry is evident in the 1997 World Competitiveness Survey conducted by the World Economic Forum, which ranked Canada 41st out of 53 countries in terms of the degree of competition from foreign banks.

If enacted, the Task Force recommendations will further alter the opportunities available to financial institutions, changing the competitive balance and fostering additional restructuring as financial institutions seek alliances that will make them stronger and more efficient. Every Canadian financial institution, large or small, will have to assess its market position, in some cases repositioning itself and in other cases re-evaluating business strategies. Some financial institutions might decide to sell uncompetitive components of their operations. Others might decide to merge or acquire institutions so as to broaden product lines. Yet this is another reason why the landscape of the Canadian financial services sector will likely be totally different in the years to come.

iv. Technological Innovations

The changing face of the financial services sector is coming from both the institutional side (being pushed by rapid technological change) and the consumer side where more convenience is being demanded (more and more Canadians are embracing new technologies). For technological change to take place, both sides of this equation must be aligned. If new, electronic delivery channels are offered by institutions, there must be consumers who accept and use them on a large-scale. If

Information technology budgets for Citicorp and Chase Manhattan — spending leaders — are estimated to have approached US$2 billion each in 1997. Another handful of major U.S. and European banks are estimated to be spending well over US$1 billion. By comparison, the largest Canadian banks are estimated to be spending in the range of US$400 to US$600 million per year.

7 McKinsey & Company, "The Changing Landscape for Canadian Financial Services — New Forces, New Competitors, New Choices," Task Force on the Future of the Canadian Financial Services Sector, Exhibit 7-10.

consumers want new products, there must be institutions who are willing and able to provide them. Institutions, products and delivery channels are all changing rapidly as a result. To address this technological challenge and to be in a position to deal with increased competition, the Canadian financial services sector has been forced to invest heavily in new technology. In 1996, the industry spent $2.92 billion in information technology (of which $2.42 billion was spent by the six large chartered banks)[8].

Leading international financial institutions are each spending well over US$1 billion annually on technology; the budgets of some, such as Citicorp and Chase Manhattan, are estimated at close to US$2 billion.

The industry is in the midst of a major transformation in the method of product delivery, which is one of the most visible aspects of the financial services sector. Bricks, mortar and indeed paper are being displaced by digital signals. The Task Force Report indicates that from 1988 to 1995, the volume of paperless payment transactions grew at an average rate 13.9 percent per year, while chequing transactions fell by an average of 1.5 percent annually.[9] In just three years, the proportion of bank-related transactions undertaken in branches has fallen from one-half of all transactions to 30%.[10] This is equal to a 40% reduction.

The availability of payments services in Canada appears good compared to other countries. The number of ATMs per person is second-highest in the OECD, and the number of point-of-sale (POS) terminals per person is third-highest.

The major alternative to the branch is the ATM, but in many respects it could soon become yesterday's alternative.[11] ATMs have been around for more than two decades. It took many years for this delivery channel to overtake in-branch transactions. Just 4 years ago, debit cards were offered to Canadians. They have

8 McKinsey & Co. The Changing Landscape for Canadian Financial Services, Research paper prepared for the Task Force, September 1998, Exhibit 5.13

9 *Competition, Competitiveness and the Public Interest*, Background paper no.1, p.15

10 This figure is an estimate for 1998. See: CIBC, Why Customer Choice and Canadian Ownership Matter, October 1997. The Task Force Research Report prepared by McKinsey & Company (The Changing Landscape for Canadian Financial Services) estimates a 21% share for branch transactions.

11 By looking at the slide entitled "The redistribution of transactions from the branches to alternative channels will continue in Canada" in Ernst & Young, Canadian Financial Institutions and their Adoption of New Technologies, Research Paper prepared for the Task Force, September 1998, one could argue that it is already yesterday's alternative.

experienced extraordinary growth since then: 30 million cards in circulation, 235,000 retailers offering Interac Direct Payment and over 1 billion transactions in 1997, compared to 185 million in 1994.

EFT/POS[12] and telephone transactions are more than doubling every year and they now account for 18% and 10% of transactions respectively, still substantially less than the 38% for ATMs. Telephone and EFT/POS transactions, are however growing at far higher annual rates (50% and 91% respectively) than ATM transactions (11%). These two channels will likely be the successors to ATMs very shortly.

Over the past 10 years, the number of Canadian households with computers jumped from 10 to 35 percent. Customers are also linking into the Internet at a rapid pace. Canada currently ranks seventh in terms of Internet hosts per capita, and these services are growing each year. Some experts are even forecasting that personal computer and Internet penetration levels will equal that of current telephone penetration within the next 5 to 10 years.)

Next in line will be PC banking. It still has a very small share of transactions but growth is rapid. Combined, telephone and EFT/POS transactions will be more important than in-branch transactions as soon as next year. Then it will be the turn of PC and Internet banking. The percentage of Canadian households with personal computers grew from 10% in 1986, to 36% in 1997. In addition, 28% of households now have access to the Internet. These are usually the younger households that conduct a disproportionate share of financial transactions and will rapidly embrace the new forms of banking such as E-money and smart cards. With these new financial vehicles and electronic commerce becoming more and more important in our economy, ATMs as we know them will become increasingly obsolete. They will have to be transformed, as their role as cash dispensing machines diminishes in importance.

Canadians appear to be openly embracing new technology. Over the past 10 years, the number of households with home computers has more than tripled. Statistics Canada reports households with home computers climbing from 10 percent in 1986 to over 36 percent last year.

To see why there is pressure for change in distribution channels, one need only look at the nature of those channels and their associated costs. In-branch transactions involve face to face contact with customers and are largely paper-based. This is by far the most expensive way to undertake a simple bank transaction. The next most expensive channel is the automated teller machine (ATM), at about one-third the cost of an in-branch transaction. These are also partly paper-based transactions, but labour is used more efficiently.

From 1988 to 1995, the volume of paperless payment instruments (i.e., other than cash and cheques) grew at an average yearly rate of 13.9 percent, while chequing transactions fell y an average of 1.49 annually.

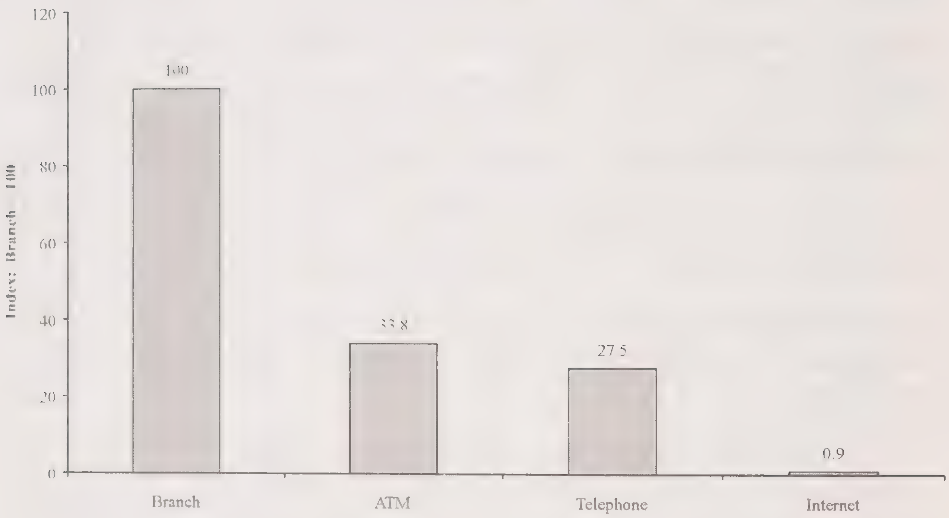
12 Electronic Funds Transfer at Point of Sale.

Two thirds of Canadians (67 percent) felt that it was extremely important to be able to do their banking in person at a branch.

Telephone banking is slightly less expensive than ATMs. It uses labour efficiently and is paperless. Finally, by far the least expensive distribution channel is the internet, with a cost per transaction that is about 99% less than an in-branch transaction. Not only is this paperless, it also needs virtually no labour.

The transition away from branches is meeting with resistance from some Canadians. In part this is a generational phenomenon. In part it may also be due to the fact that deposit-taking institutions do not charge transactions fees commensurate with the costs of the different channels.[13] Instead, they may be expecting the convenience of the alternatives to be the factor that attracts consumers.

Relative Cost of Alternative Distribution Channels



Consequently, we are seeing more than just the move away from bricks and mortar. We are seeing not just rapid change but accelerating change, and flux in the form of the new delivery channels offered to Canadians by domestic and foreign financial institutions. If monoline companies are succeeding the way they are, it is because they were able to properly customize their financial products using technological resources. These new technologically intensive delivery modes will increase competition and the choices available to consumers willing to accept them.

13 Users typically do not save much by using ATMs or telephone banking instead of using a bank branch. They do, however, benefit from the fact that these channels are far more convenient. See McKinsey & Company, Exhibit 6-29.

v. Demographic Trends

Demographic trends play two important roles in terms of services provided. As mentioned above, a younger more educated and more technologically inclined generation will mean rapid technologically advances in banking services. On the other side, an older generation of Canadians moving into their pre-retirement years and a "boomer" generation (many of whom are self-employed individuals) that will soon be benefiting from the intergenerational wealth transfer are demanding new innovative savings products, brokerage services and pension and wealth management services.

Demographics are also contributing to one of the most prominent changes in the characteristics of Canadian households, namely the way in which those households hold their wealth. We are all aware of the fact that mutual funds have grown dramatically this decade. There is an even more impressive development that has taken place over the past 25 years. This is the fact that households are increasingly holding their wealth in the form of financial assets (mutual funds, deposits, stocks, bonds and insurance products) rather than real assets (houses and other property, cars, etc.) In 1997, Canadian households held 55% of their wealth in financial assets and 45% in real assets. Twenty-five years ago the proportions were reversed.

Canadian customers are moving their assets from traditional, government-protected products like deposits to market-based securities and mutual funds. In 1992, 31 percent of financial assets were composed of basic deposits; by 1997, deposits' share of financial assets had fallen to 26 percent. Going forward, Canadians will likely take on more risk by shifting a greater share of their discretionary financial assets to long-term vehicles. Long-term assets as a percentage of total discretionary assets are forecasted to increase from 40 percent in 1996 to over 60 percent by 2006.

This increasing reliance upon financial assets is important in explaining the growth of financial services in relation to the economy. At the same time that household financial asset were growing, Canadians were changing the forms in which those assets were held. The most dramatic shift was into mutual funds. Also impressive was the growth of pension claims. Deposits, shares and bonds all declined in relative importance over the past two decades. These changes are largely in response to the pull of consumer demand, which in turn has been affected by economic and demographic factors. Low interest rates in recent years, combined with a sense that individuals need to become increasingly self reliant for their economic security, has led to an acceleration in the trend to disintermediation, i.e. the process by which savers invest directly in financial securities, especially

longer-term ones,[14] rather than using a deposit-taking institution as an intermediary. Demographic changes have led to an increasing proportion of the population being in their prime saving years. All of these developments have had an impact on the financial services sector and its various participants.

Household Financial Assets by Product (as a % of Canadian household financial assets)

	1977	1982	1987	1992	1997
Mutual Funds	1.0	0.9	3.0	5.2	14.2
Pension Claims	9.6	12.4	15.4	17.6	21.6
Shares	19.6	22.1	20.8	16.7	14.2
Bonds and MMI	11.1	10.5	10.9	8.0	5.3
Deposits	31.0	34.1	30.0	32.5	25.1
Life Insurance	10.5	10.0	10.6	11.4	10.7
Other	17.2	10.0	9.3	8.6	8.9
Total Assets in billions	$307.2	$570.1	$916.3	$1333.7	$1791.0

Source: Change, Challenge, Opportunity, Exhibit 4.1.

vi. Conclusion

The Canadian financial services sector is about to evolve as never before. Instead of resisting the forces of change, instead of seeing the status quo as a viable option, policy makers and regulators should put in place a policy framework that will help the industry and consumers adjust rapidly, easily and orderly. We now have in front of us a unique opportunity to shape the future of the financial services sector. Governments are being offered an exciting challenge that will influence the lives of millions for many years to come.

14 Households have only partial control over the allocation of their financial assets — they tend to have no control over institutional pension-related assets. Households now hold 45% of their discretionary assets in long-term form. This is expected to grow to over 60% in the next ten years, suggesting a further move away from deposits.

CHAPTER 3: COMPETITION AND COMPETITIVENESS

Competition is a characteristic of economic markets. The financial services sector, in its broadest sense, constitutes an economic market. It is a market for savings vehicles for consumers and it is a market for credit opportunities for households and businesses. In the past, however, it tended to be segregated into a number of separate markets. Every "pillar" provided a group of financial services that were not good substitutes for the services of other pillars. A savings account in a bank was not the same as a stock portfolio, or a mutual fund. The same was true on the credit side.

Today, financial institutions are becoming increasingly similar, and this convergence is aptly recognized by the MacKay Report. Thus we increasingly face a single financial market in theory as well as fact. New products and new ways of delivering them are blurring the distinction between financial instruments and institutions. This convergence takes away the ability of existing institutions to hide behind a "pillar" so as to protect themselves from competition. Examples of convergence include the fact that consumers can now buy virtually any financial product from a bank or one of the subsidiaries of a bank. Life insurance companies are increasingly becoming suppliers of savings instruments rather than providers of insurance. Similarly, a consumer wishing to purchase a savings instrument that offers a return linked to Canadian equity markets can buy a TSE-linked Guaranteed Investment Certificate (GIC) sold by a bank, a segregated fund from an insurance company, a mutual fund sold by an independent mutual fund company or a bank-marketed mutual fund.

The tendency towards convergence does not preclude specialization and niche marketing. Consumers who wish to benefit from one-stop shopping can increasingly do so while still being able to take advantage of specialist institutions (also known as monoline institutions) that provide expertise in a limited range of products. What convergence does mean, however, is that niche players must still be able to compete with full service providers.

Competitiveness, on the other hand, speaks to the ability of domestic institutions to successfully compete in the marketplace. Often the concepts of competitiveness and competition go hand in

hand, but they need not always do so.[15] With open markets and competitive domestic institutions, Canadian consumers are more likely to enjoy the benefits of competition, and thus receive the best products at the lowest prices. The reverse is also true. The greater the degree of competition in the domestic marketplace, the more successful will be Canadian institutions in the global marketplace. Competition forces firms to be efficient, to use up-to-date technology, business practices and management skills.

Consequently, we can think of competition as a feature that is important primarily from the point of view of consumers, while competitiveness is a characteristic of individual institutions or groups of institutions that enables them to operate successfully in a world of competition.

COMPETITION

There are three primary methods by which competition can be enhanced in the market for any specific financial service. This can come from new domestic entrants, new foreign entrants or by enabling existing financial institutions to offer a wider range of products than is currently allowed to them. In the view of the Task Force, the empowerment of consumers is also vital as it better enables the market to discipline financial institutions, ensuring that consumers are well served. We shall examine each in turn and consider the ways in which the Task Force Report recommendations enhance competition. To this we can add a fifth dimension, namely regulation. It is vital that regulation not prevent the adoption of efficiency enhancing techniques and technologies, or prevent the offer of efficient combinations of products. It is one thing to expand the numbers of institutions that can offer services to Canadians, but if they must do so in ways that are excessively

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15 It is conceivable that, through Internet banking for example, Canadian consumers would be able to access the services of foreign financial institutions which offer the products we want, (deposits, loans, insurance and mutual funds) all at one location. If Canadian institutions are not allowed to do the same, they would not be competitive even though consumers would still enjoy the benefits of competition. The converse could also be true. Some countries support a policy of creating "national champions," that is, national financial institutions that are also large global players. This is achieved via mergers that have the effect of creating a highly concentrated domestic market. If barriers exist in the domestic market that prevent it from being contestable, this high concentration could lead to a reduction in domestic competition. Some countries pursue policies that trade off domestic competition for the enhanced international competitiveness of domestic financial institutions.

costly not only will consumers fail to enjoy the full fruits of competition, the institutions will not be able to acquire the competitive advantage that might otherwise be theirs.

How Well Are Canadians Served by the Financial Services Sector?

In order to make an assessment of the existing degree of competition in the Canadian marketplace, the MacKay Task Force sought to establish a set of benchmarks against which the market could be evaluated. The standards that it used were essentially measures of performance in other developed nations. It is against these standards that the Task Force asked: How well are Canadians served by the financial services sector?

It concluded that Canadians are generally well served by the financial services sector. We do not enjoy the best services or prices in the world but we do, nevertheless, enjoy a high standard of service quality. A similar conclusion was derived from the results of consumer surveys. However, while the sector provides a high standard of service quality overall, it is clear that certain sectors of the economy do not feel well served at all.

Because most of [SNC's big] projects are done outside of Canada for most of them we need to provide the financing for those projects. And the financing is becoming something as important as the technical aspect related to those projects. And to put together this financing we need a stronger Canadian banking system to keep us competitive and successful in the global market place.

M. Jacques Lamarre (président et directeur général, Groupe SNC-Lavalin Inc.)

Large corporations are very well served. This should not be surprising as they have a great deal of choice. They already enjoy the benefits of globalization, they increasingly make use of capital markets and they represent the market segment of most interest to the foreign bank subsidiaries. Indeed, the interest rate spread that large companies face on bank loans in Canada is about 75 basis points less than in the United States.

In wholesale banking, the bond market is now truly global — as evidenced by the convergence in bond pricing between major markets. The total net issue of debt securities is roughly US $2.5 trillion and growing at a 17 percent CAGR*. Of this amount, international issues account for $540 billion, with Canada representing a 2 percent share.

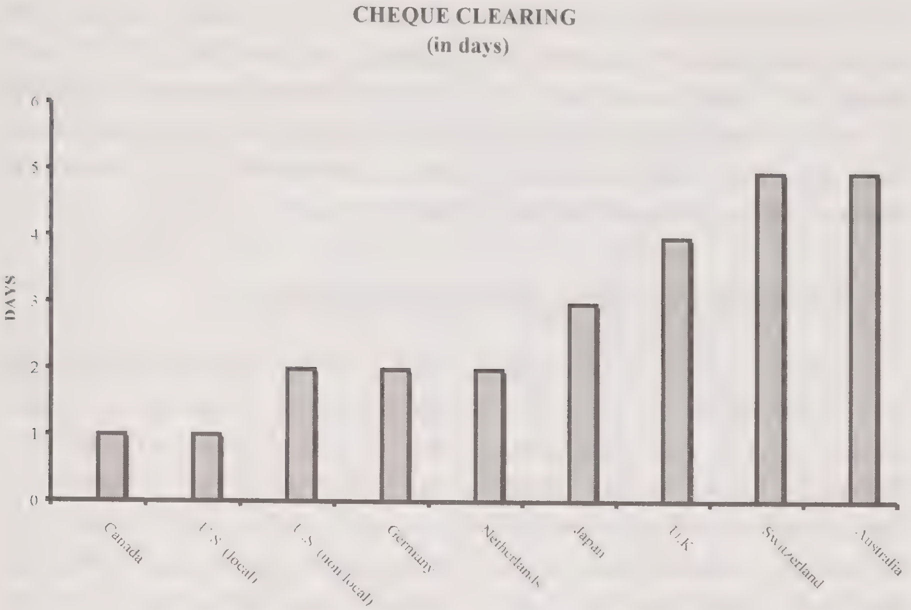
Small businesses are not as well served and again this is not surprising as their choices are more limited. They pay service fees that are lower than in the United States but more than those in

* Compound annual growth rate.

Europe.[16] More importantly, SMEs frequently complain about the lack of available credit and there is evidence to suggest that the lower interest rate spreads in Canada actually reflect the greater risk aversion on the part of Canadian banks. Those SMEs that get credit enjoy low interest rates, but the complaint of SMEs is about the fact that as a group they do not get enough credit. This is consistent with the frequently-made observation that Canadian financial institutions are unwilling to move up the risk scale and offer loans to riskier ventures.

The performance of the sector vis-à-vis Canadian households is also mixed. Residential mortgage markets are characterized by a high degree of competition. Consumers have a great deal of choice in mortgage providers and consequently enjoy very low spreads on the cost of mortgages. For one-year mortgages, the interest rate spreads here are approximately equal to those found in the United States and are one-third less than in the Netherlands, almost two-thirds less than in France and more than three-quarters less than in Italy. For personal loans, Canada again enjoys close to the lowest spreads of all major countries. The spreads here are less than one-half those found in Switzerland, Sweden, Germany or Australia. But Canadian households are not so fortunate when it comes to credit cards. We pay higher spreads (about 200 basis points) and higher service charges than do Americans and our bank service fees are just slightly above the average of the countries sampled by the Task Force.

16 At $18 per month for a typical package, the Canadian cost for SMEs' banking services are about half way between the lowest rates found in Europe and the rates found in the United States. (Background Paper #1, p. 74)



On the other hand, Canadian payments system related services are the envy of the world. Our cheques clear nationally as quickly as American cheques clear locally. Our one-day cheque clearing system puts to shame the Swiss and Australian systems that take five days for a cheque to clear, and the British system that takes four days.

Clearly then, Canadians enjoy very good financial services, but there are areas where improvements can be achieved. The fact that the Canadian financial sector is world-class in some segments suggests that it can also be world-class in the others. The objective is to discover, and remove, the factors that hinder the development of world-class service standards in those particular market segments.

But even in those product lines where we appear to enjoy high standards of service, we should not be complacent and bar Canadian consumers from the potential of even better services in the future. Public policy should not be put into a straightjacket by the doctrine of “if it ain’t broke, don’t fix it.” Canadians were not badly served by independent hardware stores and chains prior to the entry of Home Depot. Yet as a result of that entry, the market was altered considerably, competition was enhanced and consumers benefited significantly through greater choice and lower prices. The fact is, by looking only to the present, we blind ourselves from what might be. We do not know what benefits new institutions and new products can bring.

The same principle should apply to the financial sector. The burden of proof should rest with those who wish to restrict entry, not those who wish to encourage it. It should rest with those who wish to resist change, not those who promote it. As long as there is no clear threat to safety and soundness, competition, or the public interest, change should always be embraced.

1. Encouraging New Domestic Entrants

> We support the recommendations of the task force that will encourage more competition in the bank sector. In particular, we believe every effort should be made to encourage the development of new Canadian-owned banks. We would really like to see, to a significant extent, a made-in-Canada solution for more competition, not only opening the floodgates to the foreign banks.
>
> **Mr. Paul J. Lowenstein, (Chairman, Canadian Corporate Funding Limited)**

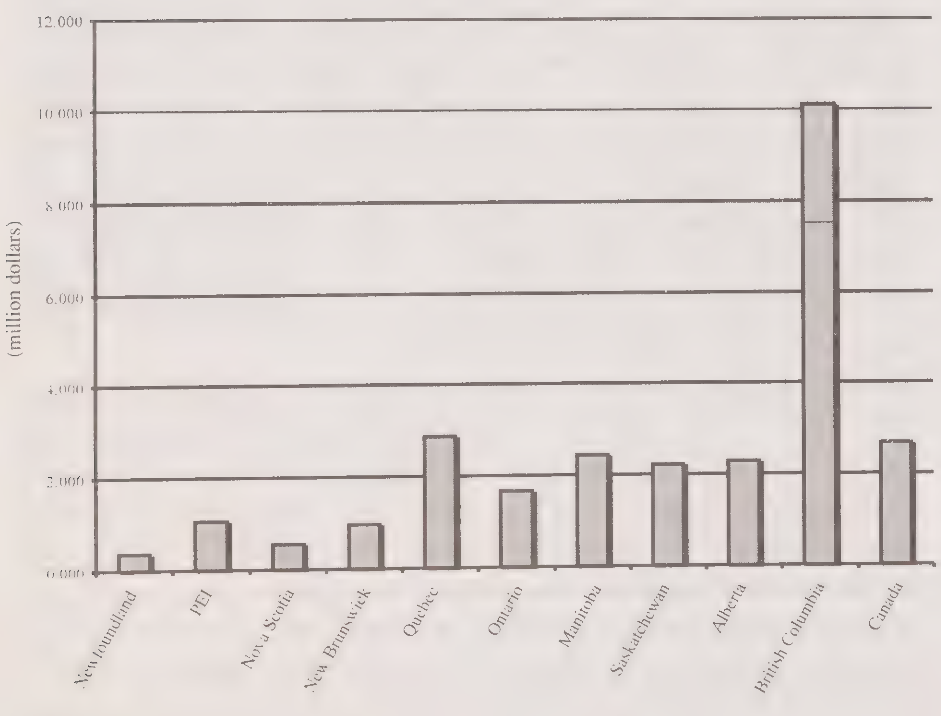
A striking feature of the Canadian financial services sector has been the lack of new domestic entrants, especially in the deposit-taking field. Canadians are proud of the fact that our financial sector has been more stable than that of our neighbour to the south. But this has both good and bad sides. While the Canadian sector has seen far fewer withdrawals through insolvency, we have also seen far fewer new institutions coming into the market. In a global market, where consolidation is increasingly common, the shortage of new domestic entrants is clearly not a tradition we would like to uphold.

The Task Force identified a number of barriers to the creation of new domestic financial institutions. The most prominent is the 10% ownership rule that applies to domestic banks. Although a new domestic bank may be closely held initially, it must meet the 10% rule within ten years. Given the fact that it takes many years for a bank to become profitable, entrepreneurs are unwilling to take on the risk of forming a new bank, realizing that they must divest themselves of the vast majority of shares just when it has the potential to become profitable.

The Task Force deals with this barrier by recommending a new ownership regime that is based on size, not the type of institution. (see recommendations 29 to 43.) Thus, according to recommendation 32 of the Task Force Report, a new bank (or federal insurance company or trust company) could be established and retain a single shareholder until equity reaches $1 billion, and a dominant shareholding could be maintained until equity reaches $5 billion. This dominant shareholder could own as much as 65% of shares if the remainder are publicly traded and widely held. It is only once equity exceeds $5 billion that a federal financial institution would need to be widely held. This recommendation effectively eliminates the existing barrier to the establishment of new domestic banks and the Committee supports the recommendation.

Existing federal financial legislation (the Bank Act, the Trust and Loan Companies Act, and the Insurance Companies Act) also hinders entry via the minimum capital requirement that it imposes on start-up institutions. At present, the legislation requires a minimum of $10 million in capital. While this requirement may have been justified on the basis of safety and solvency, it implies that $10 million in equity represents the minimum efficient size of financial institution. There are in fact many safe and sound institutions that are smaller than that, with capital that is adequate for the activities they undertake. Credit unions, being owned by members, are different from entrepreneur-owned institutions and pose somewhat different prudential risks. Nevertheless, they are deposit-taking institutions like banks and trust companies and generally have far less than $10 million in equity. The following chart, showing the average equity in Canadian credit unions and caisses populaires as of the end of 1996, shows that only in British Columbia do credit unions have $10 million in equity on average, and this result is skewed because of the existence of five quite large institutions.

CREDIT UNION AND CAISSE POPULAIRE AVERAGE EQUITY
(as of 4th quarter 1996)



The Task Force recommended that the Minister of Finance should have the flexibility to authorize the establishment of new institutions that engage in limited activities and have less than $10 million in equity. This is consistent with the 1994 report of the House of Commons Standing Committee on Industry, "Taking Care of Small Business," which argued that, subject to provisions designed to protect safety and soundness, the government should allow the creation of small financial institutions.

The Task Force also recommended that approvals be granted within 120 days and that the regulatory burden on institutions should be commensurate with their size and activities. The Committee agrees with all of these initiatives which are contained in recommendation 4.

The final component of the strategy to enhance the establishment of new Canadian financial institutions concerns the capital tax that is applied to financial institutions. Capital is the foundation of a sound financial institution, yet Canadian governments have chosen to tax financial capital quite substantially. For large and profitable institutions, this may not be an onerous burden, but for new and small institutions, who typically register losses in their early years of existence, these taxes could be prohibitive. The Task Force reports that a financial institution with $10 million in capital faces a capital tax that erodes 2.2% of its capital base annually. As these young companies are at greatest risk, the existence of these taxes constitutes a significant barrier to entry. The Task Force recommends, therefore, a 10-year federal capital tax holiday for new financial institutions and suggests that provincial governments should do likewise. (See recommendation 5) When combined with the other recommendations, this package would significantly enhance the desire of Canadian entrepreneurs to establish new financial institutions.

The objective of this recommendation is supported by the Committee, however we have difficulty in agreeing with recommendation 5 on the capital tax holiday. The financial sector is changing rapidly — institutions are disaggregating and re-aggregating. The proposed holding company structure offers the potential for even more complex corporate structures. Just what then would be the definition of a new financial institution for the purposes of this tax holiday? It is this impractical aspect of the recommendation that leads the Committee to reject it and to suggest instead that the government put greater emphasis on

creating a viable and efficient tax system in general for the financial sector. This issue will be discussed in further detail at the end of this chapter.

2. The Role of Foreign Institutions

Foreign financial institutions are increasingly important source of competition. While foreign institutions have in the past had only a marginal impact on the financial sector (Schedule II banks, for example, never captured more than 8% to 10% of the banking sector's total assets) they are now having an impact far in excess of their actual size in Canada.

These foreign institutions are adding substantially to competition not because there are many of them or because they have captured a large share of the market, but rather due to the fact that they are introducing Canadians to new and innovative ways of doing business. The new foreign bank entrants do not resemble the traditional Canadian bank, and the impact on competition is far more significant than it would have been had they tried to enter the market resembling Canadian banks.

The real benefit to Canada of the new entrants is the fact that they are introducing new and innovative ways of doing business into the Canadian market. The amount of small business lending offered by Wells Fargo is extremely small in relation to the lending now available to Canadian SMEs. What is important is the way in which the lending is offered and the group that it targets. By using techniques such as credit scoring, Wells Fargo is able to lower its administrative costs by a substantial amount and thus serve markets that were ignored by incumbent institutions. More importantly, it has now introduced a new technique of banking that others may wish to copy in the appropriate circumstances.

A similar benefit exists from the entry of new monoline financial institutions. By offering only one service, but offering quality at a low price, these firms are forcing full service competitors to meet that competition. If they used these sub-markets in the past to cross-subsidize other products, that option is now removed.

Some critics of monoline institutions denigrate their services, arguing that they are only "cherry-picking" clients in Canada, i.e. they are only taking from incumbents the best and safest, and most profitable, clients. This is clearly not the case of institutions such as Wells Fargo, Capital One and Norwest, who are taking on above

Increased foreign ownership is once again being proposed as a remedy to increased competition. It's clear that when it comes to foreign entries, foreign banks will head for profitable niches. They're not going to head for the hard-to-reach low-profit corners of the retail sectors; they'll be skimming off profitable large urban centres, catering to the more lucrative commercial and corporate clients

Mr. Peter Bleyer (Executive Director, Council of Canadians)

average risk clients. But even if the cherry-picking claim were valid, it would be evidence of a lack of existing competition, as good clients could only be lured away if they were being charged excessively high rates for services. If the monolines can, through lower operating costs, reduce market prices for services or improve the quality of those services, then those are the prices and quality levels to which Canadian consumers should have access. The Committee does not believe that legislation and regulation should be used to shield high-cost service providers from lower-cost ones as this only harms the consumer interest.

In our view, . . . there should be no connection between the proposed bank mergers and allowing foreign bank banking. No matter what decision is reached on the proposed mergers, it is clearly sound policy to allow foreign banks to operate in Canada as direct branches of the parent institution. All sectors of the financial and business communities, as well as the major political parties, media and general public strongly support direct branching by foreign banks, and acknowledge that it would be very beneficial to Canada and Canadians.

Mr. Gennaro Stammatti (Chair and C.E.O., Foreign Banks Executive Committee and President of Banca Commerciale Italiano)

Canada has now agreed under the WTO to allow foreign banks to establish branches directly in Canada as of 1999. Canada is one of only two countries that prohibit direct branching, Mexico being the other. This proposal has wide support. We concur and hence support recommendation 9.

As clearly stated by Mr. Gennaro Stammatti of the Canadian Bankers Association Foreign Banks Executive Committee, delay creates uncertainty which in turn prevents financial institutions from establishing appropriate plans to serve the market. As he told the Committee, " The government should clearly not delay any further any planning in foreign bank branching, it's almost impossible for a foreign bank to develop and implement coherent business plans for its Canadian activities when the basic ground rules are constantly anticipated to change, but never do". Hence we believe that the government should move expeditiously to allow foreign banks to operate through direct branches.

The Committee also endorses the view of the Task Force Report that Canadians should not be prohibited from using technology such as the internet to shop the world for financial services. The government should not try to erect barriers to this practice but should work to provide as much information as possible and participate in international endeavours designed to provide a more consistent regulatory framework.

International integration is a clear feature of wholesale financial markets. International integration has expanded as deregulation removed many of the barriers to cross-border transactions. Technology has assisted in this as it has increased the convenience and lowered the cost of those transactions.

Canada has always embraced globalization. Our history as a trading nation is evidence of this. As a result of increasing globalization in financial markets as well, competition is shifting to global markets rather than national or even local ones.

3. The Link Between Technology and Foreign Competition

Canadian households have not yet been subject to the effects of this globalization. The explosive growth of the Internet will change this, however. One factor currently holding up market growth is the lack of consumer confidence in the security of on-line transactions. Once this confidence threshold is crossed, however, globalization of financial markets will reach the household level in a dramatic and irreversible manner.

Once this takes full effect, Canadian households and businesses will have access to products and institutions from all over the world. Business innovations will make their way to Canadians at a rapid pace that cannot even be contemplated today. Canadian institutions that wish to retain their domestic customers will have no choice but to be as good as the best in the world, no matter where those institutions are physically located and no matter how big or small they might be. In effect, foreign institutions will be next door to any Canadian financial institution.

In the future, it will be this form of foreign competition that could have the most dramatic impact on Canadian financial institutions. These institutions will not be entering the Canadian market so much as Canadians will be virtually travelling abroad to seek financial services.

The Task Force recommendations 119 to 124 address the issues related to the provision of financial services from outside our own borders. These recommendations are designed to create an international regulatory regime for such cross border financial service providers, develop a framework for electronic commerce and provide timely information for consumers and a certification process for financial institutions. These recommendations are endorsed by the Committee and will be examined in more detail in Chapter 3.

Finally, the tax treatment of cross border interest payments also creates a barrier to enhanced competition from foreign institutions. A withholding tax of 25% is imposed on interest

payments to non-residents. In some cases the rate falls to 10% as a result of tax treaties. As it applies to gross interest payments and not spreads or profits, it actually constitutes a very high rate of tax. The impact is to either increase the borrowing costs of Canadians or deny them access to foreign sources of credit. This withholding tax directly affects lenders such as Wells Fargo, which told the Committee that the tax would amount to approximately one-half the spread it earns on loans to Canadians.[17] The Committee agrees with recommendation 8, that calls for the elimination of all withholding taxes on arm's-length borrowings.

This recommendation has its origins in the Report of the Technical Committee on Business Taxation (the Mintz Report). There already exists an exemption in Canadian tax law with respect to longer-term borrowings. If a borrower is not required to repay more than 25% of the principal amount within five years, no withholding tax applies to interest payments.[18]

Recommendation 8 is consistent with this, and simply extends the measure to shorter-term borrowings.

4. Expanded Powers for Existing Institutions

The Task Force Report sees the greatest potential for enhanced competition arising from existing financial institutions. This is a continuation of past trends whereby the crumbling of the financial pillars expanded the choices available to Canadian consumers, introduced new innovations into the delivery of services and forced existing financial institutions to adapt to the new economic reality.

To some extent this was based on market forces. Financial institutions sought ways to expand into new markets: insurance companies began offering insurance-based savings products, trust companies became more like banks and banks started to underwrite debt securities for their corporate clients. These trends prompted the government to legislate the end to the pillar system, further reinforcing market-led trends.

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17 House of Commons Standing Committee on Finance, Evidence, September 29, 1998, Issue 116, p. 27.

18 "Report of the Technical Committee on Business Taxation," Submitted to the Minister of Finance December 1997, p.6.25.

Clearly, these developments have benefited consumers. The measures, however, went only part way. Most notably, federally-chartered deposit-taking institutions were denied the ability to retail insurance and all federal institutions were prohibited from leasing automobiles. The prohibition on insurance retailing was re-affirmed in the 1996 budget on the grounds that the financial sector had not yet fully adjusted to the 1992 financial reform. The government, at that time, did not close the door permanently to insurance networking.

The other area in which the collapse of the pillars has not evolved fully is with respect to access to the payments system. The 1992 reforms were designed to permit insurance companies into the payments system via the ownership of deposit-taking subsidiaries. Other financial and commercial enterprises have long had the ability to do so through ownership of a trust company. This has not had much impact, however, as it has proved to be an expensive route to take and still did not resolve many of the barriers faced by indirect clearers.

In this respect the Task Force has recommended that life insurance companies, mutual fund companies and investment dealers have full access to the payments system (see recommendation 13). These three groups of institutions offer products that are quasi-deposits and therefore the Task Force thought they were logical participants in the payments system. John Kaszel of the Investment Funds Institute of Canada argued "access to the Canadian Payments System would help us immediately. By being participants in the payments system we can provide a seamless flow of funds between us and our clients. This will result in efficiencies for all, reduced costs, better returns. By better returns I mean there will be a minimum loss in returns during the flow period, and of course greater competition". Donald Stewart of the Sun Life Insurance Co. stated "Development in technology, consumer expectations and increased competition now make access to the payments system a necessity in order to retain and attract customers".

We agree with these witnesses and further recommend that the federal government closely monitor new CPA rules and bylaws to ensure that no new barriers to entry are erected, so as to circumvent the spirit of Task Force recommendation 13. As well, we support recommendations 14 and 15 that give the Minister of Finance the power to approve CPA bylaws and issue directives to

[W]e are urging the committee to endorse the task force recommendations relating to the payments system and to reinforce the task force's suggestion that action be undertaken as soon as possible.

Mr. Chris McElvaine (Chairman, Canadian Life and Health Insurance Association Inc., President and CEO, Empire Life)

[The] payment system is also a long-standing grievance of the insurance industry. . . . Basically, what it means is that every time we pay one of our consumers, and we pay billions of dollars every year to our consumers, we in fact send the money to a competitor's-a bank, or a credit union or caisse populaire

M. Claude Garcia (président et directeur général, Compagnie d'assurance Standard Life)

Access to the payments system would enable security firms to offer chequing privileges on client accounts directly. It would create a more level playing field for security firms to compete with banks for client business and for their financial assets and it would enable our customers to engage fully in electronic commerce through direct access to the Interac system.

Mr. Joseph Oliver (President and CEO, Investment Dealers Association of Canada)

change bylaws. An example of a rule that the Committee believes hinders competition is Rule H-4 of the CPA which prohibits one-time electronic debits or sporadic debits between financial institutions. The Committee believes this sort of rule should not be in place unless it has a clear safeguard objective.

But it also recommended that the minister had the power to review all new or revised CPA rules and to revoke any rule or revision which the minister determines to be contrary to the public interest. Well, given the number of CPA rules, the very technical nature of most of them and the need for the CPA to be able to respond quickly to emerging issues, the task force approach, in our view, would clearly be more efficient than requiring all the rules to be approved in advance by a government body.

Mr. Robert Hammond(General Manager, Canadian Payments Association)

Equally important to the enhancement of competition is the development of other networks, in particular Interac. As argued by Donald Stewart of the Sun Life Insurance Co. " . . .[M]aximizing the competitive potential of existing players requires open access on reasonable terms to other networks, in particular, we very much support the proposal that functionality in the Interac system be broadened". The Task Force recommendations 16 and 17 recognize the importance of this network. Again we are in accord. The Minister of Finance should monitor Interac developments closely to ensure that it allows competition to flourish. Improving the functionality of the systems will also add dramatically to competition as it can help to create the equivalent of large-scale networks, even for small local institutions. Technical and security problems must be resolved before allowing inter-bank deposits to be made at ATMs. In addition, the enhanced functionality envisaged by the Task Force could reduce the efficiency of the electronic payments system if it imposes a greater reliance upon paper-based transactions when the system is increasingly going electronic.

We recognize the potential benefit to consumers of added services. However, it is our view that the experts who devise and develop technology solutions are in the best position to determine how to implement innovative solutions to consumer needs. The solution in recommendation 17 is one way of addressing service to consumers but I think this committee needs to be aware that it is a costly and a complex solution.

Ms. Judith Wolfson (President, Interac Association)

In the same vein, the Committee believes that deposit-taking institutions can, under the correct circumstances, add to competition by being granted expanded powers with respect to insurance networking and automobile leasing. Expanding the powers for federally-regulated financial institutions can be a pro-consumer initiative. Nevertheless, the issue has proven to be extremely contentious. As a result we consider the matter in much more detail later in the Report.

In recommendation 13, the Task Force recommends expanding CPA membership. I want to emphasize that early in the review process, the CPA made it known that it had no objection in principle to expanding membership in the CPA. However, it was suggested that when doing this, the decision maker should be careful to consider the ramifications for the attributes of the Canadian clearing and settlement system that Canadians value so highly, and that is, it's efficiency and it's safety.

Mr. Robert Hammond(General Manager, Canadian Payments Association)

5. The Empowerment of Consumers

While governments, through such initiatives as competition policy, can seek to promote competition in the marketplace, it is the behaviour of consumers that ultimately ensures that competition will be effective. They must have choices and they must feel confident in their ability to take advantage of those choices. Earlier we discussed the potential that monoline institutions presented for the introduction of enhanced competition. But if consumers feel

coerced by their full-service financial service providers, they might not be able to take advantage of these new opportunities. All sorts of niche players could, in such circumstances, become impotent competitors.

The Committee believes it is important for consumers to feel that they are free to choose from amongst financial services and financial service providers. It is important not only to have the ability to shop around, but to understand clearly that they have this ability. They must believe that government policy is on their side. Consequently the Committee also recommends that these safeguards be well publicized, not only by financial institutions to which they apply, but by the federal government as well.

At the same time, the Committee recognizes that policies to provide consumer protection are costly to institutions and that these costs are ultimately borne by consumers. Thus there is a trade-off — more legislated and expensive consumer protection is not necessarily good for consumers.

The Committee endorses many of the Task Force recommendations with respect to greater consumer empowerment, even though they go well beyond what currently exists and might increase compliance costs. The Task Force argues that these recommendations are measures that would provide consumer protection against abuses that might result from expanded business powers.

The package of consumer protection measures recommended by the Task Force is extensive and warrants more detailed discussion later in our Report.

6. Regulation

The final tool for enhancing competition lies with the regulatory environment, which has traditionally been of vital importance to the financial sector and which is now becoming even more important. The regulatory environment has a large impact in defining the look of the financial sector, for good or for bad. While this is often recognized as a critical factor in determining the competitiveness of financial institutions, it is clear that the structure of regulation can also have a direct impact on competition as well.

The Committee has earlier expressed its support for recommendation 4 that is designed to help promote new entry into the financial sector. Recommendation 4(c) deals specifically with

small institutions when it calls for an end to a "one size fits all" approach to regulation. Complying with regulation is an activity that exhibits economies of scale. Small institutions bear a disproportionately high compliance cost while posing only small risks to the financial sector. If we wish to foster greater competition by developing a second tier of financial institutions, it is important that the government not hinder the financial prospects of such second tier institutions. It is important that regulatory measures such as risk based CDIC premiums or consumer protection arrangements not harm the competitiveness of any group of institutions.

ENHANCING COMPETITION BY ALLOWING EXPANDED POWERS FOR FINANCIAL INSTITUTIONS

A market is characterized by the existence of, or lack of, competition on the basis of the behaviour, or potential behaviour, of participants. The number of participants is a useful indicator of the structure of an industry but does not tell the entire story.

If a market is characterized by a lack of entry barriers and if there exists a group of institutions that could enter the market, it would likely exhibit signs of competition. If the participants engage in dynamic rivalrous behaviour, actively seeking to gain market share, the market will again be likely characterized by competition. Any attempt by a firm to exploit market power through increased prices will lead to a response by others, who see these higher prices as an opportunity to gain market share and increase their own profits.

The MacKay Report seeks to enhance competition by affecting both of these variables. By reducing barriers to entry, it helps to make existing markets more contestable. With entry comes rivalrous behaviour as new institutions seek to acquire additional market share.

The obvious ways in which entry barriers are to be lowered is by making it easier for foreign financial institutions to serve the Canadian market, by granting greater access to the payments system for certain classes of financial institutions, by reducing the capital requirement for new institutions and reducing their capital tax burden, by promoting the creation of co-operative banks and

enhancing the powers of credit union centrals so as to enable them to better serve their members. Another way of lowering barriers to entry is by allowing existing financial institutions to offer products that have been denied them in the past, or to enable them to use new and more efficient delivery mechanisms. This is the issue considered here. Such moves would appear to enhance competition by increasing rivalry and by effecting new entry.

As part of its quest to increase competition in the Canadian financial services sector, the MacKay Task Force recommended that the powers of financial institutions be expanded. Recommendations 13 to 17 that deal with the payments system and other networks such as Interac, have received widespread acceptance and have not been very controversial. These recommendations would expand access to the payments system to life insurance companies, mutual fund companies and securities dealers. The recommendations would also expand the functionality of the ATM network in Canada, a move that the Hongkong Bank of Canada believes would effectively create a whole host of new competitors to existing institutions.

Financial institutions are increasingly looking alike. They offer savings products that are close substitutes and these institutions are discovering that customers want a broader range of financial products from the institutions with which they deal. It is the payments system, in particular the electronic payments system, that will increasingly define the financial sector in the future. It is the expansion of access to the payments system that will finally constitute the elimination of the traditional four pillars system. As long as new participants are able to satisfy solvency and liquidity requirements, their entry is not seen as posing any threat to the soundness and high quality of the payments system we now have.[19] These recommendations were widely accepted and non-controversial.

Such is not of the case with recommendations 18 to 21, which would grant to federally-regulated deposit-taking institutions the power to retail insurance products (whether life, or property and casualty) within their branches, and use customer information, subject to enhanced and legislated privacy safeguards, to target market those products. These recommendations would also allow

What the MacKay Report comes down to is doing what's in the interest of banks and the financial services industry. It does not take into account what is good for small business, or small towns, or for the auto industry, or even for the consumer

Mr. Gilles Richard (Outgoing President, Corporation des concessionnaires d'automobiles de Montréal and President, Le Circuit Mercury (1977) Ltée)

19 Organizational Flexibility for Financial Institutions: A Framework to Enhance Competition, Background Paper #2, p. 68-73.

all federally-regulated institutions to engage in light vehicle, i.e. automobile, leasing. The Task Force sees these recommendations coming into effect only after the appropriate privacy and tied selling regimes have been put into place. These, recommendations 64 to 75, would legislate a comprehensive privacy regime in which privacy is a basic right. Consumers would have to expressly consent to the disclosure of and expanded use of personal information, and there would be a binding privacy code. These recommendations would also expand the scope of the current prohibition against tied selling and require financial institutions to provide a written description of coercive tied selling along with the advice that it is an illegal practice, prior to the signing of any contract.

Smaller institutions would be able to take advantage of these expanded powers once the consumer safeguards are in place. Large institutions, i.e. those with equity over $5 billion, would not be able to take advantage of the new powers until the year 2002.

[W]e welcome the ability to sell insurance, especially ourselves, the National Bank of Canada because our main competitor in Quebec is selling insurance. It has power both in life insurance and the P and C business. And I think it's the duty of the federal government to harmonize legislation of financial institutions, and if there's a problem with one institution being a federally incorporated institution in one province, I think that we have to do something about it. We cannot let it go.

Mr. Léon Courville (President, Personal and Commercial Bank and Chief Operating Officer, National Bank of Canada)

The primary rationale put forward by the Task Force for branch retailing of insurance is that it would expand consumer choice without imposing any great threat to consumer privacy or enhance the possibility of abusive practices. According to public surveys, less than one-third of Canadians are concerned about potential abuses. Lower income households could be served better, and at lower cost if, insurance is sold through branches of deposit-taking institutions. Furthermore, Canada is an international anomaly in this regard. Whether it be France, Germany, the Netherlands or the United Kingdom, deposit-taking institutions may own insurance subsidiaries, retail insurance in branches and use customer information to market that insurance. The "warm leads" that customer information provides enables agents to be more productive and hence lowers the cost of distribution. American deposit-taking institutions may not own insurance subsidiaries but may retail insurance and use customer information.

The Task Force further concludes that deposit-taking institutions will not drive traditional institutions and distribution networks out of the market. Both channels continue to co-exist in other countries, and with the strengthening of life insurance

companies in Canada via demutualization and direct access to the payments system, the ability to co-exist with deposit-taking rivals will likely not be jeopardized.[20]

Property and casualty insurance should experience the same outcome. Alternative distribution channels are already gaining market share with respect to household and individual auto policies. This is a result of the "commodity-like" nature of the product. Commercial insurance lines, being more complex, are likely to continue being provided by traditional channels.

The P&C sector is dominated by foreign-owned institutions. While there are many vigorous Canadian competitors, foreign-owned companies accounted for about 68 percent of net premiums earned in Canada in 1997, up from about 63 percent in 1991.

With respect to auto leasing, the Task Force again notes that Canada tends to stand apart from other industrialized nations. In the United States, where banks may lease automobiles, consumers have greater choice. This choice has come at the expense of the captive finance companies, firms which hold 80% of the Canadian leasing market, and of which three firms hold 70% of the market.

Despite the very stringent consumer safeguards that are required before these additional powers with respect to insurance networking and auto leasing are to be made available, the recommendations have proven to be extremely controversial. The Committee heard wide-ranging testimony, especially from property and casualty insurance brokers, in opposition to the extension of bank powers. These criticisms centred around several basic themes, including the ability of banks to engage in coercive tied selling, the unfair advantage banks have from the use of private information, their ability to engage in cross subsidization so as to purchase market share, and the general accusation that by driving independent brokers out of the market, competition would be diminished rather than enhanced.

Pro forma estimates accounting for the recent mergers indicate that the five largest life insurance companies will now have approximately 59 percent of the individual market and 62 percent of the group market, up from 42 and 43 percent respectively in 1991.

In addition to these complaints by insurance brokers, automobile dealers and manufacturers complained about the conflict of interest that would arise if banks were allowed to lease automobiles directly, at the same time that they finance the inventory of those dealers. It was also suggested that banks have a significant cost of funds advantage over traditional lessors, enabling them to drive incumbents out of the market.

20 Ibid. p. 96.

The vocal opposition to these MacKay recommendations is not shared evenly by all of those who would be affected by these recommendations. Life insurance agents and brokers, for example, are not as strong in opposition as are property and casualty brokers or automobile dealers. The same is true of life insurance companies. Great-West Life, and its parent Power Corp., told the Committee that it could not compete with banks marketing through their branches, although they had no problem with the current situation in which banks owned insurance companies and sold the products in traditional ways. Sun Life, on the other hand, indicated to the Committee that it believed in greater consumer choice and hence could not reject the Task Force proposal to allow the retailing of insurance within bank branches. Canada Life also did not object. Seventy-five per cent of its assets are related to savings rather than insurance products, and it could compete with bank-sold insurance products. Moreover, it has been able to compete effectively with banks in the United Kingdom and Ireland where "bancassurance" has been available for more than 10 years. ManuLife also felt that it could be as competitive as banks, even with in-branch retailing of insurance products, as long as the power was phased in gradually. Mutual Life, while tentative, did not oppose expanded powers to retail insurance. Rather, it suggested that time would be needed for the competitive inequities between life insurance companies and deposit-taking institutions to be erased. New powers to retail insurance should await such developments.

The Task Force Report recognized that life insurance and general insurance products are quite different, but it also concluded that the regulatory issues surrounding the co-mingling of deposit taking and insurance sales are the same for both types of products. Hence its analysis concentrated on life insurance products, where the bulk of the international experience lay.

[The Task Force's] assessment of jurisdictions, and by that I mean provinces in Canada and other countries, where deposit taking institutions are allowed to sell insurance and offer lease financing shows that traditional insurers, lease financing companies and auto dealers can and indeed do co-exist, compete and thrive in the market place alongside deposit taking institutions.

Mr. Raymond Protti (President and Chief Executive Officer, Canadian Bankers Association)

The background studies and technical papers examined the international experience in delivering life insurance through the banks. European countries have, for some time now, allowed "bancassurance" or "allfinanz" models to exist. The development of these models was the result of demographic changes and tax advantages available to certain insurance products. In France, where bank sales of insurance products has been allowed since the 1970s, the bank market share exceeds 50%. The bank share is also high in Italy, at over one-third. In other countries, banks have

not been able to acquire as significant a share of the insurance market. The advantage of new distribution channels is largely cost related. The cost of bank distribution of life insurance products is about one-half the cost when an independent broker is used. Further substantial cost reductions occur when direct sales are undertaken.

Most of the insurance sold by banks is life insurance, although the Royal Bank of Scotland pioneered the sale of general insurance through telephone call centres. In the United States, banks sell insurance products and many Canadian life insurance companies have their products sold this way.

The Committee is not convinced that competition cannot be enhanced if federal financial institutions are granted additional powers. What is needed is a set of other prerequisite reforms to ensure that enhanced powers prove beneficial. The Committee's assessment of the various arguments is presented below.

Our industry therefore urges this committee to recommend that enactment and implementation of effective action relating to the payment system and consumer compensation arrangements should precede any change whatsoever in the current legislative and regulatory framework for insurance distribution by deposit takers.

Mr. Chris McElvaine (Chairman, Canadian Life and Health Insurance Association Inc., President and CEO, Empire Life)

In general, opponents of expanded powers assume that the banking sector is not characterized by competition and will not be characterized by competition in the future. They have little faith in the effects of current market trends that are increasing competition. They also get little solace from the recommendations of the Task Force, that are designed to increase competition and enhance consumer protection. Thus any initiatives that enable banks to gain market share must be at the expense of competition. This is however, a conclusion that must be established rather than just asserted.

Increasing bank presence in certain industries does not mean that competition has been lessened. Much is made of the fact that banks now dominate in the provision of certain services that were denied them in the past. If banks have gained market share because they proved to be more efficient, and therefore able to offer services at a lower price, consumers gain — they do not lose.

The consumer finance market is a good example of this. Finance companies lost market share to banks because those banks were able to undercut the rates charged by the incumbent institutions. Consumer loan rates fell with the entry of banks into the

market. The spreads between consumer loan rates and the bank rate are lower today than in the 1950s, when banks had one-half the market share they have today.[21]

Finance companies are largely unregulated, so there are few barriers to entry. If banks were exploiting market power via higher prices, these unregulated companies could easily enter the market to re-capture market share. The fact that they have not done so in large measure over the past 40 years is indicative of competition in the market. The fact that banks now have over two-thirds of the consumer lending market is an indication of the results of competition, not its absence. The same can be said about residential mortgages. Banks have gained over half the market, compared to about 10% in 1970, yet there is widespread consensus that this is probably the financial service that has the most competition of any other. The mortgage rate spread, measured by the mortgage rate and the average yield on 3yr. to 5yr. government bonds, is substantially below that of the 1970s.[22]

The securities sector is no different. Banks have captured three-quarters of the market through acquisition over the past decade, yet in many respects fees for services have come down, partly due to changes in regulation and partly due to directly increased competition.[23] Again this is not something that one would expect of a market in which the banks can exercise market power.

It is equally important to consider the evolution that is already taking place and that will continue to take place, even in the absence of new powers for federal institutions. The threats to incumbents are already manifesting themselves. P&C insurance is very much a commodity rather than a financial service, which will increasingly be sold in non-traditional ways such as direct marketing, call centres, etc.

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21 E.P. Neufeld and H. Hassanwalia, "Challenges for the Further Restructuring of the Financial Services Industry in Canada," in G. M. von Furstenberg, The Banking and Financial Structure in the NAFTA Countries and Chile, Kluwer Academic, Boston, 1997, chart 12.

22 Ibid. Chart 13

23 Commissions, expressed as a proportion of trading volumes on the TSE and MSE, have fallen from 1.6% in 1987 to less than 1% in 1995. It is over this period of time that the banks came to dominate the securities sector. (Royal Bank Financial Group, Three C's of Canadian Banking: Conduct, Competition, Concentration, February 1996.)

P&C insurance companies in many ways face the same dilemma as the banks. They have an existing distribution network that has served them well in the past, but technological changes and consumer demands are creating pressures to find better ways to deliver those products. They must work their way through this transition without alienating customers who are comfortable with the existing distribution channels. According to a study done by Coopers & Lybrand for the Task Force, " . . .in other countries, a substantial proportion of the broker market overall could quickly erode as insurers continue to seek new channels of distribution that offer advantages of speed and convenience to consumers."[24]

The P & C sector is a mature industry in Canada. The fact that the majority of insurance is distributed through independent brokers is not an affinity on the part of the insurers towards brokers, but rather it's a recognition that the broker distribution system is efficient and is cost effective. These and many important industry related facts have been totally ignored by the MacKay Task Force.

Mr. Gil Constantini (President Elect, Insurance Brokers Association of Ontario)

Similar developments are taking place in the sale of automobiles, which might help to explain the opposition of dealers to bank direct leasing. The emergence of internet brokers such as Auto-by-Tel, is reducing dealer margins on car sales,[25] something that will be increasingly common in the future. Bank direct leasing of automobiles would further this trend.

The Specific Arguments Against Expanded Powers

Cross Subsidization: One particular criticism of bank entry into insurance retailing concerns the ability of banks to cross subsidize insurance products so as to gain market share. Cross subsidization, however, does not rely upon branch distribution. It is possible now. At issue though is the extent to which it would actually take place and the extent to which it undermines competition if it does take place.

To cross subsidize one product means that the price of that product is kept below the cost of production, with the difference financed by revenues in another product line. The ability to engage in such a practice requires that there be a product line that is not subject to competition, and hence generates the excess profits that can finance the subsidized line of products. It requires a lack of competition amongst deposit-taking institutions, which is precisely how opponents characterize the financial sector in Canada.

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24 Coopers & Lybrand, "The Property/Casualty Insurance Industry," Research Paper prepared for the Task Force on the Future of the Canadian Financial Services Sector, p. 31.

25 DesRosiers Automotive Consultants Inc., Background Report on Extending Bank Powers to Include Light Vehicle Leasing, p.15.

The portion of business funding derived from bank loans reached a peak of over 50 percent in 1982-83 and has since declined to less than one third. Corporate customers have turned to lower-cost capital markets and asset-backed finance firms for their funding needs.

Banks are increasingly facing enhanced competition. It is coming from monoline institutions that are entering the credit card market. It is coming from capital markets where commercial firms are bypassing banks to get financing directly.[26] It is coming from mutual funds that are an alternative to bank deposits and GICs.[27] The issue, however, is whether these trends and the effects of the Task Force reforms are sufficient to address the perceived anti-competitive impacts of insurance networking.

The other important fact to consider is the structure of the market in which cross subsidization might take place. If it is characterized by trivial entry barriers, no predator will ever be able to exploit the market share that it purchased via cross subsidization, because once it did so, new institutions will always be able to respond to profit opportunities by entering the market.

The property and casualty insurance sector has few barriers to entry, as admitted by the industry. The same is true of automobile leasing, which is a largely unregulated industry.

Use of Client Information: Another allegedly anti-competition effect of allowing deposit-taking institutions to retail insurance comes from the unfair advantage that banks and others have in being able to use client information to target market that insurance. Banks know more about Canadians than does any other type of financial institution.

The MacKay Report addresses this by recommending the establishment of a number of measures designed to protect consumers. These include a legislated system of privacy safeguards, enhanced tied selling prohibitions and an independent ombudsman regime. With consumers being given the ability to define their relationship with a financial institution the potential for abuse is substantially reduced. Today, many Canadians feel that they are not adequately protected against abuse of their privacy. Unless the standard of consumer protection is substantially enhanced, insurance networking could subject them to even greater potential abuses.

26 Bank loans now account for 34% of corporate debt, whereas they accounted for 44% of debt 10 years ago. (Report p. 49)

27 In 1991, bank personal deposits, at $216.5 billion, were 4.3 times as large as mutual funds. In 1997, those same deposits, at $290.3 billion, were only 1.02 times as large as mutual funds.

Abusive Tied Selling: Finally, there is the matter of economic power and coercion that might be exercised through tied selling. The Committee deals with this matter elsewhere in the Report, and has accepted the MacKay recommendations that would significantly tighten up the prohibitions against tied selling. When combined with the other consumer protection measures recommended by the Task Force, we believe the package would constitute an effective set of safeguards for consumers when enacted.

All financial institutions have a reputation to maintain and it is that reputation that enables them to attract and keep customers. Several institutions have made it clear to the Committee that ill-advised behaviour on their part brings with it significant threats to their customer relationships. Attempts at coercive behaviour do not just risk the potential that the additional business might not materialize, it brings with it the risk that other, existing business may be lost as well. This constraint on abusive practices would only be effective if consumers had the mobility to change institutions.

In sum, MacKay is all about a vision of what is good for the banks. It is not about what is good for small business.

M. Gérald Drolet (President, Canadian Automobile Dealers Association)

Unfair Cost of Funds Advantage: The automobile dealers who vehemently opposed direct leasing by federal financial institutions often cited the unfair advantage that banks have over traditional lessors, because of their ability to raise funds through low-cost deposits. Lessors could never be competitive with banks as a result.

Deposit-taking institutions have a wide variety of costs in addition to the interest they pay on deposits. The interest rate spread is not indicative of profit margins. More importantly, the large leasing companies are some of the most stable and profitable firms in the world. With their strong credit ratings,[28] they are able to raise very low cost funds via commercial paper, without the need of an extensive retail branch network to support.

Secondly, deposits are becoming less and less relevant as a source of funds, primarily because consumers are shifting to mutual funds. Mutual funds already exceed personal deposits in the banks and they will soon exceed all deposits in size. At the margin, deposit-taking institutions that would finance auto leases in

28 GE Credit, for example, has a AAA credit rating which is higher than that of any Canadian bank.

As you undertake this review, it is important that you be aware of the fact that the MacKay Report contains several crucial errors. For example, it claims that the caisses populaires in Quebec are able to lease vehicles directly, so why shouldn't banks be allowed to do so as well? In reality, that statement is false. In Quebec, the caisses populaires have signed an agreement with auto dealers stating that that they will not engage in any direct leasing.

Mr. Gilles Richard (Outgoing President, Corporation des concessionnaires d'automobiles de Montréal and President, Le Circuit Mercury (1977) Ltée)

the future will raise funds in ways that are probably not much different from the way existing lessors raise funds. They will have no significant advantage as a result.

Conflict of Interest: One of the most longstanding arguments against bank direct leasing of automobiles is that it would place them in a conflict of interest position in relation to dealers, whose inventories are also financed by banks. On the one hand dealers would be their customers, on the other they would be competitors.

The Montreal Automobile Dealers Association quoted the former Assistant Deputy Minister of Finance in this regard, when he said in 1990

> Fundamentally, the government in devising this policy (of limiting bank lease powers) has been driven by a view that there is a large potential conflict of interest here at the very local level. If banks were also in the leasing business we are not confident that we could deal with those conflicts through regulations and limitations . . . . I am the bank manager in Perth, Ontario . . .I am sitting there making credit decisions related to the car dealer down the street's leasing activities, but I am in the same business in the back of my bank. I do not know how to deal with that in a fundamental, inherent kind of way.

This concern has merit if dealers have no alternatives but banks for financing. However, all of the vehicle manufacturers have captive financing arms. These are designed to provide financing so as to help move the cars that are manufactured. Today, most of that activity is concentrated in providing leasing, but it need not be so. The captives do provide loans and if dealers felt that banks were treating them unfairly, they could seek financing for inventory acquisition from these captives. More importantly, if the state of competition is increased sufficiently, these dealers would have more options available to them to finance their inventory.

Finally, the conflict of interest as expressed in the above quote refers to a situation in which the bank branch has its own inventory of cars. This is not the way the banks say their leasing products would be offered. Canadians cannot avoid dealerships when obtaining a new car. This is true whether they purchase through the internet or lease from a credit union. What banks claim to want is the ability to provide another alternative for dealers. Instead of only being able to draw upon captive finance institutions (e.g. GMAC, Ford Credit), independent lessors like Newcourt and GE Capital, and some provincial institutions such as caisses populaires and

credit unions, the dealer would be able to draw upon the services of banks as well. Dealers would always be the ones brokering the lease. While banks cannot buy cars directly from manufacturers, it is possible that they could in fact have an inventory of used cars at the expiry of the initial leases. At this point there is a fear that they could become direct competitors to auto dealers.

But some banks already offer near lease products such as buy back loans that can lead to their taking possession of cars at the end of the loan contract. They pre-arrange the sale of those cars with other institutions and do not market the cars themselves.

Leasing and Risk: While opponents want banks out of automobile leasing because they will unfairly harm existing lessors, they also want banks out of the business because banks do not understand the market. They don't understand residual risk the way incumbents do. The American example where banks lost money in this area and subsequently exited the market, is cited as proof of this lack of knowledge.

It is important that banks understand the risks associated with all of the activities they undertake. OSFI is concerned with this as well. But financial institutions are in the business of assessing a whole host of risks. When they engage in derivatives trading, they must assess risks that most ordinary individuals could not understand. It is unlikely that the risks associated with automobile leasing are so unfathomable, especially since banks are already offering near-lease products that require them to understand the nature of these risks.

Capital Cost Allowances: An argument that has been raised late in the hearings concerns the capital cost allowances associated with direct leasing. Banks want to engage in leasing so that they can capture the capital cost allowance and shield their already high profits from taxes.

Capital cost allowances (CCA) are available to all lessors and to the extent that they reduce current taxes, they do so for all, not just the banks. What is more important to realize, however, is the fact that the CCA can only be applied against income from the lease of the capital goods that are subject to the CCA. It cannot be used to shield other sources of income from current tax.

In conclusion, the Committee believes that the arguments made by opponents to expanded powers are not definitive. Consumer demands are evolving and the methods by which

products are distributed are also changing. These factors are putting pressure on incumbent suppliers in all sectors of the economy. The Task Force recommendations will speed up these trends but they are not the source of the pressures that insurance brokers and automobile dealers will face in the future.

The Committee does believe that there are some legitimate consumer-related concerns that relate to the expansion of powers for federal financial institutions. That is why we recommend that an enhanced system of consumer protection be implemented quickly. There are also some legitimate concerns about competition. That is why we also support the task Force recommendations that would promote new entry.

The Committee believes that, subject to the concerns for safety and soundness, individual financial institutions should be able to establish their own business strategies, delivering the products that they see fit to deliver and to deliver them in what they think is the most efficient way. They should be able to respond to the changes taking place in the economy. These are business decisions. Similarly, consumers should be able to buy their financial services in ways that are most beneficial and convenient to them. These are individual decisions. As long as both sets of decisions are taken in markets that are competitive, consumers will benefit.

Leasing of new vehicles in 1997 was a $35 billion business, with the financing arms of the major auto manufacturers having 70 to 80 percent of this market.

The retail automobile market is changing rapidly, with leasing becoming increasingly popular largely as a result of rising car prices. Forty-six per cent of new cars are now leased vs. only 4% in 1990. Why should federal financial institutions be shut out of this market which they have traditionally served through car loans, because of changing consumer trends? Why should they be shut out of this market when some of their provincially-regulated competitors are not? Why should foreign finance companies be shielded from bank competition here when they are not so shielded in their home country? In the United States, banks have been able to lease automobiles since the 1960s, and it appears that they have done so mainly at the expense of captive finance companies. Most other countries do the same. What is so different about the Canadian economy that our consumers should be prevented from enjoying this option?

A similar tale could be told with respect to insurance. Many countries now allow banks to retail insurance, which provides customers with lower cost distribution channels. Indeed, in

countries where banks are allowed to distribute insurance products, productivity in the distribution system is higher than in Canada. Why should Canada not take advantage of this and why should it continue to be the international anomaly?

A recent C.D. Howe publication had this to say about bank entry into the Australian and New Zealand insurance market.

> Despite the relatively large number of incumbents in the Australian and New Zealand insurance markets, bank entry has increased the level of competition substantially. This result has occurred because the banks have introduced a new distribution technology to the industry, rather than because of any pre-existing lack of competition . . .[29]

This is an interesting example because it deals directly with some of the arguments used by opponents of expanded powers. Whether it be insurance retailing or auto leasing, these opponents will frequently cite the large number of current market participants and assert, as a result, that the market already benefits from competition. "If it ain't broke, don't fix it" they say. The Committee believes that there are potential benefits to consumers from new suppliers of auto leases and new distribution methods for insurance products. We do not believe, however, that the conditions are right today.

The Committee believes that the state of competition in the Canadian financial services sector will be enhanced by the recommendations of the Task Force Report. We also believe the current system of consumer protection to be inadequate. We recommend therefore that the government give high priority to the establishment of a new consumer protection regime, and act quickly to do so. Such a regime would include:

- An improvement in the transparency of contracts and the full and timely disclosure of contract terms (Task Force recommendations 57 to 62)

- Enhanced, legislated privacy safeguards that that would allow the consumer to control the use of personal information, by requiring explicit customer consent

29 I. J. Horstmann, G.F. Mathewson and N.C. Quigley, "Ensuring Competition: Bank Distribution of Insurance Products" C.D. Howe Institute, May 1996, p. 86.

which may subsequently be withdrawn (Task Force recommendations 64 to 69)

- A legislated and expanded ban on coercive tied selling, along with a redress mechanism and a requirement that financial institutions inform customers as to what practices constitute coercive tied selling, prior to a transaction being completed (Task Force recommendations 70 to 75)
- A redress mechanism that includes an independent financial services sector ombudsman (Task Force recommendations 76 to 80)
- The establishment of a Consumer Protection Bureau.

The Committee recommends that the House of Commons Standing Committee on Finance be instructed to evaluate the new consumer protection and competition regime in order to determine whether or not it is effective and raises the standard of protection for consumers. This evaluation is to be conducted prior to the next scheduled review of federal financial institutions legislation, and receive input from stakeholders.

Therefore, the existing prohibition against federally-regulated deposit-taking institutions retailing insurance in their branches, as well as the existing prohibition against federally regulated financial institutions leasing automobiles, will only be reconsidered in light of the results of the above-mentioned evaluation.

COMPETITIVENESS

The Committee's interest in enhancing competition reflects its concern about the welfare of consumers. As many witnesses have stated, the ultimate goal of financial reform is to benefit the consumer. It is the consumer interest that ultimately produces the greatest benefit to Canadians. Whether consumers are households or business firms, a financial sector that is good for consumers is good for the economic welfare of all Canadians.

But having expressed the primary consumer interest, the Committee wishes to make clear that financial policy should also allow Canadian institutions to pursue the measures that will make them globally competitive. In other words, we should pursue those

measures that allow our institutions to become world class in all respects. After all, this sector directly employs more than one-half million Canadians and has a significant impact on our economy in its own right. Furthermore, as was argued earlier, Canadian consumers are more likely to enjoy the benefits of competition with open markets and competitive domestic financial institutions.

Competitiveness is a characteristic of an institution, a group of institutions or the entire sector. If Canadian financial institutions are to compete effectively and profitably with their counterparts around the world, they must be equipped with the appropriate tools. They must offer the same products as their competitors, or better products. They must offer them at prices that are no higher. And, if they are to do so at a profit, their costs must be in line with those of others.

I feel that the best protection for our Canadian banking system is to give them the size and the economies of scale that they need to compete. The competition is there. I don't believe that this will create any kind of monopoly as market forces will prevail. Market forces say to me that mergers would be good, giving us world class financial institutions.

Mr. Glen Calkins (Owner/Operator, McDonald's Restaurant of Saint John and Lquispansis)

Canadian financial institutions have for many years now faced this competitive challenge from their foreign counterparts when operating in the international marketplace. Increasingly, they are facing the same challenge at home.

Canadian financial institutions generally rank favourably in terms of international competitiveness. While not the best, they generally are in the top ranks of financial institutions. Moreover, banks and life insurance companies typically have an international orientation that surpasses many of their much larger international competitors. According to The Banker magazine, for example, Canadian banks are very much globally oriented. If banks are ranked by the proportion of their assets that are non-domestic, Canadian banks rank 20th (CIBC), 21st (Bank of Montreal), 27th (Scotiabank) and 39th (Royal) in the world. Both CIBC and the Bank of Montreal have 44% of their assets overseas, and the Bank of Montreal earns 58% of its earnings overseas. Scotiabank earns 49% of its income overseas, while Royal earns 28% abroad. By this measure, the Bank of Montreal and CIBC are more globally oriented than Chase Manhattan, Bank of Tokyo, and ING.

Canadian bank profitability compares reasonably well with that of foreign banks in major countries.

In its 1997 report, the World Economic Forum ranked Canada's financial system fifth in competitiveness, among a sample of 53 more-developed countries.

In addition, the Canadian regulatory environment has helped to make Canadian institutions more competitive. The reforms of 1992 and earlier have permitted the emergence of nation-wide domestic financial conglomerates, unlike the situation in other countries such as the United States.

Nevertheless, there are certain areas in which initiatives can be undertaken to enhance the competitiveness of domestic institutions and the competitiveness of Canada as a centre of financial services.

As noted above, the Task Force Report recommended that financial sector convergence be allowed to proceed further. The primary effect of this would be to expand consumer choice. But it would also enhance the international competitiveness of those institutions by allowing them to better serve consumers and thus become more profitable. As a Bank of Canada report concluded, it is profitability that really matters in determining whether financial institutions are truly efficient. It concludes that, " . . .the key issue may not be so much the size of FSPs [Financial Service Providers], but rather the nature of the activities they undertake."[30] It is vital, in our view, that Canadian financial institutions be able to serve Canadians they way they want to be served. This will allow them to be competitive. The Committee recommends that both aspects of the recommendations be considered when they are assessed by the government.

The other primary way in which competitiveness is to be enhanced is via the rules governing ownership and structure of financial institutions. We consider here the four principal groups of recommendations contained in the Task Force Report, namely the ownership regime, the flexible definition of wide holdings, the process of demutualization of large life insurance companies and the financial holding company model. In addition, we discuss the problems that the co-operative sector has in becoming a competitive force in the domestic marketplace.

Ownership

Manulife supports the task force recommendations of the widely-held ownership regime also referred to as the 10% shareholding limit be retained for large institutions in perpetuity. This policy has served our industry and our country well. Without it, I am convinced that our financial services sector would not have evolved into as strong and competitive sector that it is today nor would it be domestically controlled as it is today.

Mr. Dominic D'Alessandro (President and CEO, Manulife Financial)

The ownership regime recognizes existing and potential trends towards greater convergence and thus recommends that all federal financial institutions be subject to the same rules, based on size. As the ownership regime can confer certain advantages on the one hand and certain costs on the other, it was felt by the Task Force that all institutions, who will eventually be able to do similar things, should enjoy the same benefits and bear the same regulatory costs.

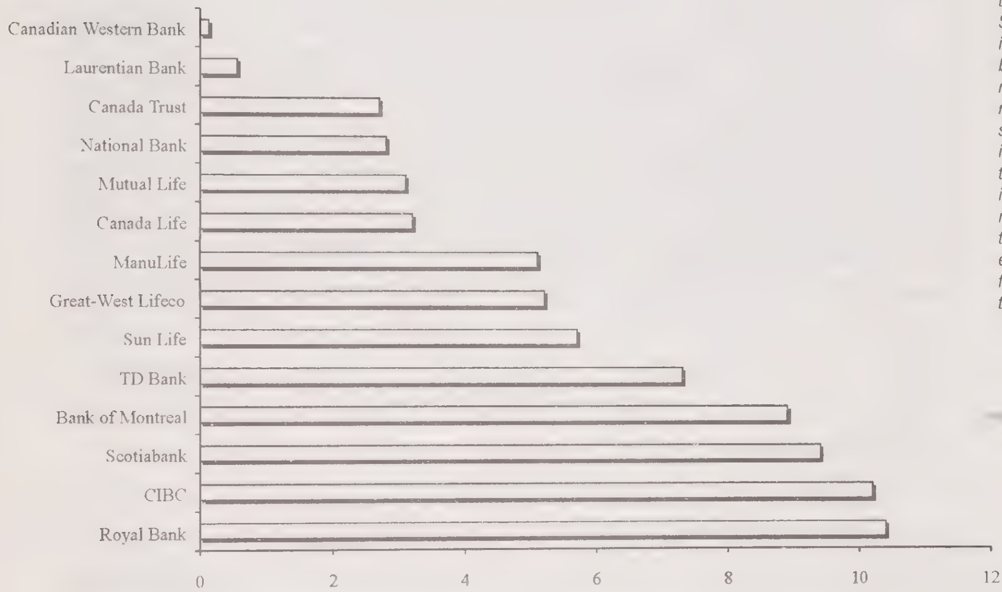
30 C. Freedman and C. Goodlet, "The Financial Services Sector: Past Changes and Future Prospects," Bank of Canada, Technical Report No. 82, March 1998, p. 21.

Recommendations 29 to 41 deal with the ownership regime that is to apply to federally-regulated financial institutions. According to the Task Force, there should no longer be one set of rules for banks and another set of rules for non-bank financial institutions. These recommendations also effectively address the issue of the ownership regime that is to apply to mutual insurance companies after converting to stock companies. The following chart, based upon Task Force data, ranks the large Canadian financial institutions by equity and places them within the context of the new size thresholds.

Recommendations 29-41 propose a number of changes to the rules concerning ownership of financial institutions. If these recommendations were to be accepted, they would alter the current rules in important ways. Some schedule one banks and mutual insurance companies which chose to be de-mutualized, would no longer be required to be widely held. Ownership requirements would be based on the size of the institution. It's our view, and it's a view shared by most regulators, that closely held ownership of financial institutions provides greater scope for risk than widely held ownership, and that commercial links further exacerbate the risk. The history of financial institution failures in Canada tends to support this view.

Mr. John Palmer (Superintendent, Office of the Superintendent of Financial Institutions)

Domestic Financial Institutions
Equity 1997 in $ billions



Recommendation 29 sets out the three guiding principles for a set of ownership rules. This regime should foster entrepreneurship and thus enhance competition. It should maintain safety and soundness of the system and it should preserve Canadian control.

By requiring large institutions (i.e. those with equity of $5 billion) to be widely held, the Task Force believes it is promoting safety and soundness of large financial institutions by avoiding the problems and conflicts associated with commercial links. It also maintains Canadian ownership because no foreign institution could take control of a domestic institution via an unfriendly take-over. On the other hand, by allowing small institutions (i.e. those with no more than $1 billion in equity) to have a single owner, new entry and entrepreneurship is promoted. At present,

The task force recommendation permitting new banks to be closely held or single ownerships of banks with less than $1 billion in shareholders' capital and up to 65% ownership for banks with shareholder equity between $1-5 billion, with the remaining 35% to be widely held and publicly traded, we believe will go a long way to broaden the choice of providers of financial services to Canadians. This will be particularly well received by Canadian mid-market corporations, as well as smaller corporations.

Mr. Paul J. Lowenstein, (Chairman, Canadian Corporate Funding Limited)

The task force is proposing widely held ownership for the large institutions, whose failure would have systemic implications. Widely held ownership is not just a Canadian ownership rule, it's a safety and soundness rule because, all other things being equal, widely held institutions tend to be safer than closely held institutions.

Mr. John Palmer (Superintendent, Office of the Superintendent of Financial Institutions)

entrepreneurs may start up and keep control of trust companies and insurance companies. The Task Force proposes to allow, for the first time in recent history, entrepreneurs to create and maintain control of domestic banks. Financial institutions with equity between $1 billion and $5 billion may be closely held as long as 35% of shares with voting rights are publicly traded and widely held. The rules for this middle category are roughly equivalent[31] to the ownership rules that now apply to federal non-banks with equity in excess of $750 million.

Where an individual holds an interest in more than one federal institution, it is the combined equity of the institutions that will determine the appropriate ownership parameters.

The Committee believes that this proposed regime offers a good compromise between the conflicting ownership rules now in place and the size distribution of existing institutions. Only Canada Trust and Great-West Lifeco violate the proposed rules, the former because its 35% public float is not in the form recommended by the Task Force, and the latter because it is closely held and has equity in excess of $5 billion. The Report recommends that the current ownership rules applying to both institutions be grandfathered. Control of the institutions could change hands once without affecting the grandfathering provision. Any subsequent change of ownership would require eventual compliance with the new ownership regime.

Under this proposal, all of the big Canadian banks must continue being widely held, as the smallest of the big five, i.e. the TD Bank, had equity of $7.3 billion in October 1997. Sun Life and ManuLife, once converted into stock companies, would also have to remain widely held. All other financial institutions in Canada could continue to be closely held, some with a 35% public float and some without. Some widely held companies such as Canada Life and Mutual Life could eventually be closely held. And the National Bank, Laurentian Bank and Canadian Western Bank could all choose to be recategorized and become closely held.

31 Canada Trust violates the Task Force proposals because its 35% public float is not made up of shares with voting rights.

This regime offers great scope for entrepreneurs to create and/or grow their financial institutions into major players before having to give up ownership control. The $5 billion limit for wide ownership is a level one-half the size of the Royal Bank and the CIBC, the two largest Canadian financial institutions.

This new ownership regime could change the look of the Canadian financial sector. There are, for example, currently a number of initiatives underway between banks and retail chains that provide consumers with new ways of obtaining financial services. Examples are PC Financial offered by Loblaws and CIBC, the TD Bank/Wal-Mart marketing agreement, and the plan to have ING deliver services through Canadian Tire stores. These initiatives create new distribution channels, they do not create new financial institutions.

With the new ownership regime proposed by the Task Force, new possibilities arise, a Loblaws Bank or a Wal-Mart Bank, for example. Such banks would be truly new institutions, not just new ways of delivering the services of existing institutions. There is no guarantee that firms would take up the opportunity offered by the Task Force changes. As long as that flexibility exists, however, the door to new entry is open.

A Flexible Definition of Wide Holdings

As part of this proposed regime, the Task Force proposes a flexible approach to the definition of wide ownership, which currently means no individual or group of individuals may own more than 10% of any class of shares. According to the Report, wide ownership is no longer to apply to Schedule I banks but to apply instead to all large federally-chartered financial institutions. Wide ownership guarantees Canadian control, something that the Report sees as important to the preservation of Canadian jobs and also vital to the service of the Canadian market. But wide ownership also restricts institutions in their ability to forge alliances and make acquisitions. As recognized by the Task Force, share equity is often a currency that is used in corporate acquisitions. By limiting individual shareholdings to 10%, the value of this currency to Canadian financial institutions is diminished, especially when making very large acquisitions. Consequently it recommends that the Minister of Finance be given the power to permit somewhat more concentrated shareholdings in certain circumstances. With global consolidation to achieve greater efficiencies a reality, the

Task Force attempted to facilitate the participation of Canadian financial institutions in that trend. The Committee endorses the proposals contained in recommendation 33.

Holdings in excess of 10% are not to be allowed for purposes of portfolio investment, but rather as part of a business strategy designed to foster alliances and acquisitions that would enhance the competitiveness of the financial institution. Recommendation 33(b), that limits to 45% the total shareholdings of individuals who have received permission to hold more than 10% of any class of shares, limits the number of times that a financial institution may use this strategy — it could have three shareholders with 15% each or two with 20%. Should a transaction that is in the public interest be prohibited just because an exemption from the 10% rule has been used previously? Consequently, the Committee believes that the intention of any restriction, such as that found in recommendation 33(b), should be clarified.

The third part of recommendation 33 allows the Minister to temporarily permit a shareholding in excess of 20% in certain circumstances, although voting rights could not be exercised on the excess. Again, the Committee agrees with the recommendation in principal, but we believe that it is too vague. Does the Task Force have in mind a temporary shareholding of 25%, or 35%? The 45% limit in 33(b) would presumably include this temporary excess and thus could work to prevent future strategic alliances. Again, the Committee believes that the government should clarify the conditions under which such an exemption would be granted and the consequences it would have for financial institutions. It should also indicate the time period in which divestiture is to take place. The Committee believes that if the government were to accept recommendation (33), it should establish parameters that would clearly define the limits of such discretionary power.

The Committee also supports recommendation 32(e) which states that "A widely held, regulated financial institution that is incorporated in Canada should be able to hold up to 100% of the shares of another regulated financial institution, regardless of size. This is an interesting recommendation that has some potential to effect profound change upon the financial sector. It means that, subject to the merger review process, the large Canadian banks could, for the first time in recent memory, be subject to a hostile take-over bid by another bank or another widely-held financial institution. While there is a very obvious size difference between the

Schedule I banks and Sun Life or ManuLife, it is not inconceivable that they could mount a take-over bid for one of the current group of Schedule I banks. The ability to mount such a challenge could be enhanced by the flexible definition of wide ownership that the Task Force recommends.

As noted above, the new ownership regime proposed by the Task Force includes a grandfathering provision that would allow Great-West Life and Canada Trust to maintain their current ownership structure. Both could grow and acquire other institutions, without their parents having to divest ownership control.

Grandfathering still imposes certain restrictions on these two institutions, however. Although both can acquire other institutions, neither may acquire an institution with over $5 billion in equity, as such an institution must be widely held. These rules do not restrict them from acquiring several smaller institutions. Thus, referring back to the earlier chart, it is evident that Great-West Life could buy Canada Life or Mutual Life, or even National Bank. It could not buy ManuLife, unless its owner is willing to sell its controlling interest in the insurance company. ManuLife, on the other hand, could buy Great-West Life.

Canada Trust is also similarly restricted by these grandfathering provisions. On balance, both these firms gain much more from the reforms proposed by the Task Force than they lose from being subject to a new ownership regime. The reforms envisaged by the Task Force open up a whole new array of options in terms of acquisitions and powers. Their ability to grow into strong institutions is heightened by the Task Force recommendations, not diminished by them. The Committee therefore supports these grandfathering provisions.

The Importance of Canadian Control

The Task Force recommends a flexible and innovative ownership policy for Canadian financial institutions. It would facilitate the creation of strategic alliances, helping financial institutions become more competitive in the Canadian market place and become world-class financial institutions. It would allow entrepreneurs and commercial entities to own smaller institutions and it would ensure that large institutions are free from commercial linkages that, in some circumstances, could be damaging to the

safety and soundness of the financial services sector. With the Task Force proposals, the Governor-in-Council would be able to consider foreign acquisitions of large Canadian institutions in exceptional circumstances, if it is in the Canadian interest.

Canadian ownership of global concerns ultimately means keeping more jobs in Canada. As a strong financial centre, we have the opportunity to maintain and to continue to build a world-class talent pool, but if we are held back and the giants to the South are able to penetrate our markets while keeping many of those jobs offshore . . .where does that lead?

Mr. A. Charles Baillie (President and Chief Executive Officer, Toronto Dominion Bank)

This new regime is structured to preserve domestic control of the largest Canadian financial institutions. Indeed, there was virtual unanimity expressed during our hearings on the need to maintain domestic control of our financial services sector. New foreign entry was generally welcomed, but most thought that the industry should be primarily Canadian and the largest institutions should be domestically owned and controlled.

The Task Force defines a Canadian-controlled financial institution as one " . . .managed by Canadian-based executives subject to Canadian governance requirements and not subject to the direct influence of a dominant foreign interest." [32] By this definition, an institution that is widely held by non-Canadians, could still be Canadian controlled. Domestic ownership helps, however to promote domestic control.

The Committee believes that domestic ownership and control has served us well in the past and will continue to do so in the future. Canada is not alone in ensuring domestic control over large financial institutions. New Zealand, for example, stands alone among developed countries in having its banking sector foreign-controlled.

Important benefits flow from Canadian control. The first benefit is regulatory. By having decisions made in Canada, regulators can exercise effective moral suasion in a way that would not be possible when decisions are made elsewhere. As the Task Force suggests, it is the governance of institutions that matters from a regulatory perspective. Domestic control ensures that governance rests with Canadians, in Canada. Indeed, New Zealand has essentially given up its direct supervision of financial institutions in light of the fact that the industry is not domestically controlled.

There are other direct, economic benefits of a Canadian-controlled financial services sector. It means institutions headquartered in Canada, with senior management jobs here. Other high-quality and high-skilled jobs would also be located in Canada, creating a large talent pool of Canadians with specialized

32 Competition, Competitiveness and the Public Interest, Background Paper #1, p. 172.

skills (lawyers, computer specialists, software analysts, marketing specialists, lending officers, economists, accountants, etc.) There are, for example, 165,000 employees directly employed by the financial services sector in the Greater Toronto Area alone. Canada's banks are major private-sector employers. In 1997, the banks and their subsidiaries directly employed more than 221,400 people in Canada. Without Canadian control, many of these jobs would be located abroad. Canadian institutions largely serve international markets from Canada, employing Canadians and paying Canadian taxes. Without domestic control of our financial services sector, the reverse could easily be true. Foreign institutions serving Canada from abroad, employing non Canadians and paying taxes elsewhere.

A domestically controlled financial services sector also means more sensitivity to the needs of Canadians. It has been argued that foreign controlled institutions could withdraw from the Canadian market during periods of weak economic conditions. Such behaviour was characteristic of Japanese banks operating in the United States in the late 1980s.

Canadian control means more contribution and involvement in Canadian communities. For example, Canadian banks donated $66 million to Canadian charities in 1997. Through corporate giving and sponsorship initiatives, banks contribute to programs in support of youth, education, health and welfare, arts and culture and economic development.

Canadian-based financial institutions, headquartered in Canada, pay taxes in Canada. In 1996, all financial institutions paid a total of $8.4 billion in federal, provincial and municipal taxes.

Finally, even though Canada is a small player in the world financial services arena, it is important for us to have domestic financial institutions participate and compete. Part of Canada's economic power is derived from the presence in international markets of a strong, sound and safe, Canadian-controlled financial services sector. Part of Canada's sovereignty comes from having strong domestically-controlled institutions that are more likely to be immune to the extra-territorial effects of foreign laws.

The Committee believes that control of Canadian financial institutions should remain primarily in Canada. Non-Canadian institutions should of course be allowed into our market. What is essential, however, is the ability of domestic institutions to continue

to prosper. As proposed by the Task Force and endorsed by this Committee, the new ownership regime will be more flexible. We believe it will act in the best interests of Canadians.

The most important way to keep domestic control of the industry is to ensure that, in a world of increasing international competition, our domestic institutions are able to compete and thrive. The greatest threat to a domestically-controlled financial services sector is inefficiency and poor profitability. The Task Force recommendations in general foster continued Canadian control as they help in the achievement of enhanced competitiveness.

Demutualization

The MacKay task force pointed out that it believed de-mutualization will be in the best interests of the mutual companies, their policy holders and the future evolution of the financial services sector. We believe that this is true and our board has asked Canada Life to prepare a plan for de-mutualization and we are actively engaged in doing that.

Mr. David A. Nield (President and CEO, Canada Life)

Many of our largest life insurance companies operate under a unique ownership structure, whereby certain categories of policyholders have rights that are somewhat akin to ownership rights. This mutual form of ownership has protected the institutions from take-over but has also hindered their ability to raise capital and therefore grow, whether internally or via acquisition. Consequently, the largest mutual companies have announced their decisions to convert from mutuals to stock companies.

Like the Task Force, we support the government's proposals to allow large mutual life insurance companies to convert into stock companies. We also support the government's policyholder safeguard measures as well as the desire to protect these companies from hostile take-over in the period immediately following conversion. The Committee agrees with the Task Force Report that converted companies should have more flexibility in seeking affiliations that would enhance their own competitive position.

In ManuLife's case, given the quality of our franchises and the strong potential of our businesses around the world the reality is that once demutualized we, and in my view, other demutualizing companies would represent attractive take-over targets. The task force has recognized this situation and has recommended a three-year transition period free of hostile take-overs and merger proposals. It is our view, however, that this is too brief a transition period and that a five-year period would be a more realistic timeframe in which to establish ourselves as strong, stand-alone public companies.

Mr. Dominic D'Alessandro (President and CEO, Manulife Financial)

A two-year transition period is proposed in Bill C-59. The MacKay Report recommends a three-year transition. We reject the call to extend it to five years as the MacKay recommendation provides an adequate transition period. The Committee sees the transition period as one which protects the newly-converted institution against certain circumstances, not as one which confines the institution to a straightjacket, limiting its ability to pursue business strategies. Just as these companies have expressed the need to proceed with the demutualization process quickly, we believe that the newly-converted companies should be able to expeditiously undertake the business strategies that would

allow them to better compete with the bank-centred financial groups that now exist, as well as other foreign conglomerates that have been formed or that are being formed. The financial world is evolving rapidly. Delay can be costly. With two bank merger proposals on the table, and consolidation taking place around the world, it is vital that the rest of the sector be able to undertake the measures necessary to permit the creation of new, strong competitors. Thus the Committee recommends that the Minister be permitted to consider applications for amalgamation or acquisition from the Boards of Directors of converted institutions during the transition period. Such an application is not to be considered unless it has been approved by shareholders.

Financial Holding Companies (FHC)

Another component to the strategy to enhance competitiveness rests with the proposal to allow financial institutions to organize themselves under the umbrella of a regulated financial holding company. The parent holding company would be a non-operating company whose sole purpose is to raise capital that would subsequently support the activities of subsidiary financial institutions. It would be subject to a very light form of regulation, with OSFI being concerned primarily with transactions amongst affiliate institutions and the parent and its subsidiaries.

Although the Task Force Report did note that the use of the holding company model could permit more nuanced regulation, it did not specify what these nuances would be. Indeed, the Report did not go very far in exploiting the possibilities for regulatory reform that a financial holding company model could permit. Many analysts have recommended the use of financial holding companies as a way of targeting the appropriate form of regulation to those activities that most deserve regulatory attention and relieve from regulation those activities that do not present any prudential concerns. By doing so, the use of holding companies could transform our regulatory system to one that effectively regulated functions. This would lead to greater regulatory consistency and resolve some of the imbalances that currently exist, or that have the potential to arise.

The Committee believes that the Task Force could have gone further in taking advantage of the opportunities presented by the use of the holding company model. Indeed, the Task Force acknowledges that its quest for greater competition could actually

produce a competitive imbalance between domestic and foreign financial institutions. The proposed financial holding company model, as recommended by the Task Force, does not necessarily resolve this. Just as competition should not be sacrificed to allow domestic institutions to become more competitive, competitiveness should not be sacrificed in the quest for enhanced competition. The Committee believes strongly that competition and competitiveness are natural allies and financial sector policy should reflect this.

We are pleased that the task force agreed with our submission that federally-regulated institutions should be given the flexibility to organize into holding company structures. This would achieve a level playing field with minimally regulated businesses in areas such as wholesale leasing and financing.

Mr. Joseph Oliver (President and CEO, Investment Dealers Association of Canada)

The Committee is well aware of the benefits that the holding company model could offer to smaller institutions wishing to form alliances with other institutions, so as to better enable them to compete. We believe this recommendation should be enacted quickly.

The government could go further, however. While we feel that the model has promise and should be pursued, we are struck by the general lack of enthusiasm amongst the witnesses that we heard. Few financial institutions and witnesses expressed great interest in it. Donald Stewart of the Sun Life said "We believe there are potentially significant business advantages to the holding company structure, including more efficient regulation, greater flexibility for raising capital, and the potential for greater value for shareholders of the holding company." Such enthusiasm was rare, however.

The Committee recommends therefore that financial institutions that take advantage of the FHC model be allowed to incorporate unregulated subsidiaries, creating a consistency with the treatment of current unregulated holding companies. This would also provide a greater consistency with the treatment of foreign financial institutions which may enter Canada as both a regulated financial institution and an unregulated institution. The Committee also recommends that the regulation imposed on the FHC be as light as possible and that over time, unregulated financial holding companies become regulated ones. This would be triggered when such an institution is sold a second time.

Accounting Rules

The accounting rules that apply to Canadian financial institutions in the face of certain types of consolidation have come under criticism because the rules make it more difficult for these

companies to undertake the transactions necessary to become more efficient. These rules adversely affect the perceived income of financial institutions, adversely affecting their market value and therefore their ability to use share equity as currency in acquisitions. They also create a bias towards mergers amongst equals.

Furthermore, these accounting rules produce an inconsistency in the way that assets must be reported on the books and the way in which OSFI views those assets for purposes of the capital base of financial institutions. The Task Force suggested that Canadian accounting rules be changed in order to eliminate the adverse impact they have on the ability of Canadian institutions to restructure. (See recommendations 42 and 43.)

The most articulate observer of the problems associated with accounting rules was Henri-Paul Rousseau of the Laurentian Bank. When financial institutions of differing size merge, goodwill is created. That goodwill is not recognized as part of the capital base by OSFI. It must, however, be included in the assets listed on the corporate balance sheet, and then depreciated over a certain period of time. This depreciation creates a charge against reported income and, as a result the future reported profit stream of the institution will be lower, and the market capitalization will likely be reduced as well. In addition, the acquiring institution must satisfy OSFI that it has sufficient capital to support its acquisition, at the same time that it must write off some of the assets that it purchased. Mr. Rousseau summarized the problem very well: "On the accounting side it is a recognized asset, but on the regulatory side it is not an asset, so we create the first difference between the accounting balance sheet and the regulatory balance sheet. . . .[N]ot only do you need additional capital, but part of the cash that you paid for has disappeared because we now recognize the good will as an asset. This is a double-whammy situation we have."

These rules reduce the incentives for Canadian institutions to restructure themselves, and create a competitive imbalance with American institutions who are better able to restructure without the creation of depreciable goodwill. While the generous American

accounting treatment is likely to change in the future, it will likely go to the UK model where goodwill is treated as an asset but only expensed if it is impaired.[33]

The Committee was told that the CICA announced a few weeks ago that new accounting rules should be in place by the Fall of 1999. The Committee supports this initiative. In our view, a revision of the accounting rules would not only enhance the competitiveness of financial institutions, it could also help to enhance competition. Financial institutions wishing to consolidate will have more options, domestically and internationally, and not be forced into mergers of equals as is now the case.

The Co-operative Sector

Across Canada, co-operative financial institutions offer an alternative to the for-profit, entrepreneurial institution that characterizes most of the sector. Credit unions and caisses populaires account for 10% of the assets held by deposit-taking institutions in Canada. Their strength varies enormously from province to province, however. In both Quebec and Saskatchewan, these co-operatives hold more than 35% of assets. In Manitoba the share is 25%. In Newfoundland, Nova Scotia and Ontario, the share is 5% or less.

These data clearly illustrate the strength of the co-operative movement. Its strength and appeal obviously varies across the country, however, reflecting differences in social culture or market alternatives.

Nevertheless, there is a great deal of strength in the co-operative movement. The question is, then, how to tap into this strength so as to make them more competitive and hence add to competition? These institutions are typically very small and thus suffer from the fact that they have not been able to achieve economies of scale. Only in British Columbia, does the average credit union have more than $200 million in assets.[34] This is due to the fact that five credit unions have more than $900 million in assets, with Vancouver City Savings having close to $5 billion in assets.

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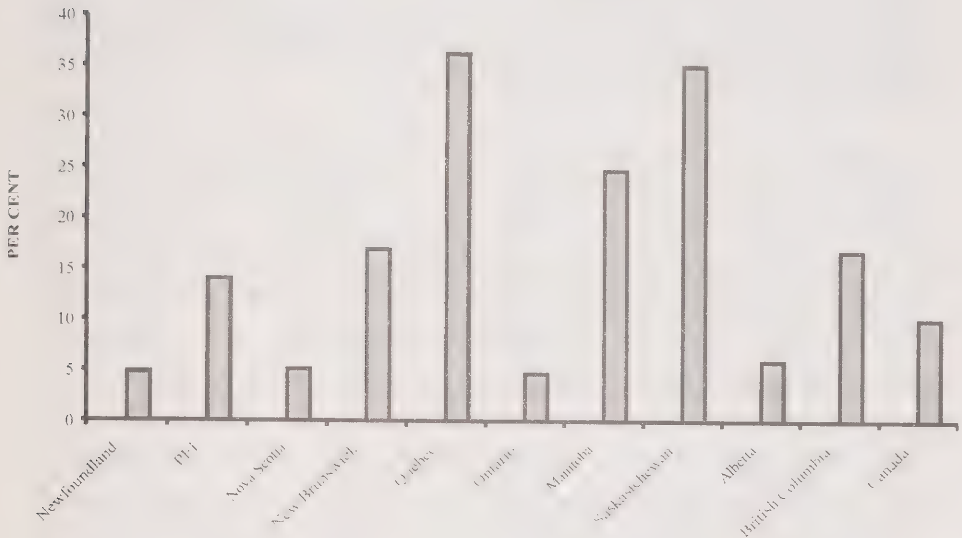
33 *Change Challenge Opportunity*, Report of the Task Force on the Future of the Canadian financial Services Sector, September 1998, p. 104-105.

34 "Organizational Flexibility for Financial Institutions: A Framework to Enhance Competition," Background Paper #2.

The average asset size in Alberta is about $50 million, while it is slightly higher in Manitoba. In all other provinces, credit unions and caisses populaires have less than $50 million in assets, on average.

CREDIT UNION AND CAISSES POPULAIRE
SHARE OF DEPOSIT TAKING ASSETS



The fact that they are co-operatives makes it difficult to raise capital for growth. As a result of this small size, they are not able to take advantage of the powers available to them — only 75% of credit unions offer a full slate of services, for example. This is evidenced by the fact that credit unions and caisses populaires earn fee income equal to about 20% of net interest income. For banks, however, this ratio exceeds 50%,[35] indicating that they sell a large volume of services other than direct credit.

The restrictions that credit unions face are compounded by the fact that they may not provide services across provincial boundaries.

There are two ways to address these problems. One solution that has been proposed is the creation of one or more co-operative banks. (See recommendation 22) The Committee accepts this recommendation. As co-operative institutions are effectively widely held we see no reason to deny them the option to collectively own banks. This is consistent with current federal policy. Citizens Bank is owned by Vancouver City Savings, a credit union. If a single credit union may own a bank, why should a group of credit unions not be

35 Ibid, p. 113.

able to do likewise? In addition, mutual insurance companies are allowed to own banks, due to the fact that those insurance companies are effectively widely held.

Finally, we note that the new ownership regime proposed by the Task Force allows greater flexibility. Small institutions, i.e. those with less than $1 billion in equity, may be owned by a single shareholder. Consequently, a co-operative bank would not conflict with this proposed ownership regime.

When the proponents of such a co-operative bank appeared before the Committee in Vancouver, they recommended that deposits be insured to a maximum of $100,000. This was justified on the grounds that deposit insurance for members of credit unions varies across the provinces and is often more generous than it is for CDIC insured deposits. In some provinces there is, in effect, an unlimited guarantee. Despite the fact that the Chairman of the CDIC did not express any major objection to this suggestion, the Committee rejects this. A co-operative bank would have all the powers of existing banks. This is as it should be. Such a bank should enjoy no special benefits and should be treated like other banks that are members of CDIC.

Not all credit unions, however, want to be part of a bank. For them, it is more important that the federal and provincial legislation governing credit union centrals be amended to allow them to provide better and more efficient services to their members. The *Co-operative Credit Associations Act* prevents this, however. The Committee endorses amendments to the *CCA Act* and recommends quick action on the part of the federal government. Thus we support recommendation 24 that would allow centrals to offer services to individual credit union members, not just the credit unions, as is now the case.

The other aspect restricting the ability of centrals to better serve credit union members is the requirement that they must set up service corporations to serve third parties, and then are limited in serving only financial institutions that own a substantial stake in that corporation. These backroom services enjoy significant economies of scale. A central can achieve such economies of scale only by serving non-credit union institutions as well as credit unions. The above noted restriction prevents them from achieving these economies. Bill Knight of Credit Union Central of Canada clearly summarized the problem " . . .[I]f Centrals wish to provide

services to other financial entities or wish to provide retail financial services, they must do it through a subsidiary which they own. . . .This is extremely costly in terms of the establishment of these subsidiaries." To achieve economies of scale, credit union centrals should be able to incorporate subsidiaries that offer services to other financial institutions without requiring those clients to first make an investment in that service providing subsidiary. We therefore support the changes recommended by the Task Force Report.

Taxation

We have earlier dealt with the impact of taxation on the state of competition. Here we deal with the effects it could have on the competitiveness of financial institutions.

In 1996, the Canadian financial services sector paid more than $8.4 billion in taxes to federal, provincial and municipal governments. The financial sector paid nearly 20% of federal corporate income tax even though it represented only 17% of total corporate profits. The average tax rate for deposit-taking institutions was 26%, (compared to 6% for the mining industry, 12% for agriculture, forestry and fishing and 17% for the communications sector).[36]

A recent study by Statistics Canada indicates that the financial sector accounted for 25 percent of all corporate taxes paid in 1994 (compared with 14 percent in 1988) and only 12.5 percent of total operating revenues. From 1988 to 1994, the financial sector's contribution to total corporate taxes roughly doubled, whereas the contribution of the non-financial sector increased by 5 percent.

Federally regulated financial institutions are subject to unique corporate taxes. In addition to the 0.225% large corporation tax imposed on corporations with capital of more than $10 million in Canada, the industry is also subject to unique federal and provincial capital taxes. The federal capital tax (Part VI tax imposed on institutions with more than $200 million in capital) has been imposed at a rate of 1.25% on deposit-taking institutions since 1986 and on life insurance companies since 1990. Unregulated financial institutions are exempt. Since 1995, there has also been a temporary surtax (Part VI capital surtax) imposed on the largest deposit-taking institutions which is set to expire in 1999. There is also a graduated surtax for life insurers.

The federal large corporations tax of 0.225 percent of capital is applicable to companies with capital of more than $10 million, capturing almost all financial institutions.

In 1996, regulated financial institutions paid $350 million in federal capital tax and $522 million in provincial capital taxes.

Over 60 percent of the $872 million in capital taxes paid by financial institutions in 1996 was collected by the provinces.

36 *Report of the Technical Committee on Business Taxation*, December 1997, p. 4.2.

Capital taxes have numerous perverse effects. These taxes are counterproductive since they increase the cost of capital, hence the cost of doing business. Our financial services sector is less competitive as a result.

Capital taxes are also perverse from the point of view of sound prudential management. Financial institutions are required to maintain capital for prudential reasons, yet the tax produces incentives to minimize the amount of excess capital they hold.

As mentioned in the Task Force Report,[37] a small deposit-taking institution with only $10 million in capital, could expect to pay $219,500 in annual capital taxes (2.2% of its capital base) even if not profitable. This is particularly critical for new financial institutions having no income against which to credit the capital taxes. Under these circumstances, new entrants could be obliged to drain monetary resources, undermining their strength.

With respect to taxation, I think the MacKay commission also said that a capital tax was a bad tax. We certainly adhere to that point of view, but, again, would like to make the point that there is again a discrepancy here in our own treatment. The Mouvement Desjardins in Quebec doesn't pay or pays very little capital taxes and we pay a lot. They start at the beginning of the year with $100 million less taxes than we do. This is a big gift on January 1.

Mr. Léon Courville (President, Personal and Commercial Bank and Chief Operating Officer, National Bank of Canada)

Canadian banks paying the large corporations tax and the Part VI surtaxes face a much higher effective tax rate than credit unions or non-financial institutions. There is clearly not a level playing field in the tax treatment of lending activity in Canada. This places them at a tax-induced competitive disadvantage in the domestic marketplace.

Capital taxes are costly to comply with due the lack of co-ordination among the various governments. The capital tax base varies from jurisdiction to jurisdiction. The Task Force also raises the issue of the effect that cascading taxes such as the GST, sales taxes and premium taxes can have on consumers.

The imposition of the capital taxes penalizes those institutions whose operating principles call for higher levels of capital for the protection of their consumers. We endorse the task force recommendation to eliminate the special capital taxes and look to legislators to take action in this area.

Mr. Richard May (Vice-President, Canadian Fraternal Association)

The Committee agrees with the general observation that the level of taxation of Canadian financial institutions is damaging to their competitive position and is increasing costs to Canadian users of financial services. It is urgent that the government introduce a method of taxing financial institution that is fair, appropriate and reflects the real economic activity. Robert Astley of the Mutual Life Insurance Co. identified the true problem when he told the Committee: " . . .I would argue for an effective income tax regime to supplant and replace a capital tax regime that has all the wrong incentives built into it".

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37 Task Force Report, *Competition, Competitiveness and the Public Interest*, Background paper no. 1. page101.

The recommendations made by the Task Force relative to capital taxes and cascading taxes (see recommendation 44) should be acted upon as soon as the budgetary position of the federal and provincial governments will allow. Recommendations 44 b) (ii) and (iii) do not have adverse revenue implications for governments.

As mentioned earlier, capital taxes can be seen as a significant barrier to entry for new and smaller institutions. The Task Force proposes a 10-year holiday for new financial institutions from federal capital taxes (see recommendation no. 5). The Committee does not support this recommendation, in light of what was just recommended, i.e. the replacement of capital taxes by profit-sensitive taxes. Even though what is recommended by the Task Force would favour new entrants and likely increase competition, all the perverse effects of the actual special capital tax on existing financial institutions would remain. For example, as stated by Mr. Gerald Soloway of the Trust Companies Association of Canada: " . . .[C]apital taxes are a significant barrier to entry for smaller institutions. We would say why limit a ten-year holiday for capital tax to new institutions. We would suggest both existing and new members of this sector need this kind of support. We believe the government needs to go further and eliminate capital taxes for small institutions both new and existing."

Furthermore, if defined broadly, this tax holiday could benefit foreign financial institutions (including large deposit-taking institutions), further enhancing the unlevelled playing field observed in the domestic market.

Finally, it remains to be seen what the definition of a "new" financial institution would be. Would it only be Canadian-controlled institutions? Would it apply to subsidiaries in which a financial institution held only a small interest?. The immediate solution lies in recommendations 44 b)(ii) and (iii) and not in further enhancing the unlevelled playing field. In the long term, the priority should be recommendations 44 a) and 44 b)(i) that deal with neutrality of the tax system and the elimination of special capital taxes imposed on financial institutions.

CHAPTER 4: FINANCIAL SECTOR CONSOLIDATION AND THE MERGER REVIEW PROCESS

Around the world, financial institutions are consolidating their activities, repositioning themselves to face a new market environment. Not only are they merging with other domestic financial institutions but they are increasingly aiming at institutions operating in the rest of world. Grant Reuber of CDIC described this as "...an era of turbulence in the financial services sector everywhere in the world." This new dynamic environment is characterized by the arrival of world-wide mega-financial institutions.

Mergers and Acquisitions Around the World

The face of international banking is being transformed by the wave of mergers and acquisitions sweeping across Europe, North America and Asia. An accelerating world-wide consolidation movement exists in the financial services industry, with an estimated 4,000 mergers and acquisitions taking place globally every year.[38]

In Europe, many important mergers and acquisitions have been announced since 1997. These include Unicredito/Credit Italiano (April 1998), Generale Bank/Fortis (May 1998), UBS/SBC (December 1997), ING/BBL (November 1997), Crédit Suisse/Winterthur (August 1997) and Vereinsbank/Hypobank (July 1997).

The forces driving consolidation in European banking are numerous:[39] overcapacity in the industry, increased competition from US powerhouse banks, loss of national protection, deregulation, weak earnings growth in many banking sectors and rising demands on the part of shareholders for better returns. The imminent arrival of the European Monetary Union is magnifying these forces.

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38 McKinsey and Company, *The Changing Landscape for Canadian Financial Services*, Research Paper prepared for the Task Force on the Future of the Canadian Financial Services Sector, September 1998, Exhibit 4-4.

39 Euromoney, *Euro-gigantism*, February 1998.

In Europe, governments in smaller countries such as Holland and Belgium have encouraged their banks to consolidate to improve efficiency and ensure that their industries can remain strong in the face of growing competition from much larger financial institutions in neighbouring countries.

Mr. Al Flood (Chairman and Chief Executive Officer, Canadian Imperial Bank of Commerce)

As a measure of the pace of consolidation, between 1980 and 1997, the total number of banking organizations fell from 12,333 to 7,122 in the United States. This was accompanied by an increased concentration of the market, as illustrated by the fact that the percentage of total deposits held by the top 25 organizations rose from 29 percent to 47 percent over that same period.

The total value of bank-related mergers in the US in 1997 was US$73.5 billion, roughly double that of 1996, despite the fact that the number of consolidations fell from 357 to 304 between 1996 and 1997. This is partly explained by the record premiums paid for new acquisitions in 1997.

[L]ast quarter we saw Nations Bank commit to two loans of almost $4 billion Canadian each. At our size, we would only be able to commit to around half that amount on a single loan. The fact is that as more and more of our clients merge they will be seeking larger loans. Larger banks are better positioned to provide these loans.

Mr. A. Charles Baillie (President and Chief Executive Officer, Toronto Dominion Bank)

European bankers argue that size matters. They believe that European banks need the increased scale to spread growing information-technology and processing costs over a larger revenue base. Another important key driver behind many bank mergers in Europe is the need for greater market capitalization. European governments and their regulators appear to have accepted the view that greater size is crucial to cost cutting and the creation of strong banks.

In the United States, things are also moving very rapidly. Within a three-day period in April of this year, three major mergers were announced: the cross-country marriage of NationsBank/BankAmerica, the mid-west linking of First Chicago NBD/BancOne and the Travelers Group acquisition of Citicorp. Since then, Wells Fargo announced an agreement with Norwest. To partially complete the list of mega-mergers that took place over the last 18 months in the United States, one would have to add the mergers announced by National City/First of America, Salomon/Travelers and NationsBank/Barnett Bank, as well as all the mergers between US banks and securities firms (such as BankAmerica/Robertson Stephens, NationsBank/Montgomery Securities and Bankers Trust/Alex Brown).

The trend in the United States can be explained by many reasons, such as the belief that size matters in order to compete in a global banking environment, pressure for increased spending on information technology, economies of scale in areas such as asset management and global custody, pressure to cut costs in the domestic market by consolidating overlapping organizations and the advantage of having banking and other financial services provided under one roof. There is also a uniquely American force at work, namely the elimination of the longstanding prohibition against nation-wide banking.

As the corporate clients of banks, and their financing needs, become increasingly global, and as technological innovation continues, the pressure to merge is becoming more powerful. Not only are financial institutions trying to realign themselves by merging across business lines and within domestic markets, they are increasingly attempting to cross international borders. For years now, financial institutions have been looking at foreign financial institutions as possible take-over targets. For example, the Dutch Bank ABN Amro owns LaSalle National Bank of Troy New York, Midland Walwyn was recently bought by Merrill Lynch and the

Bank of Montreal previously bought Harris Bank of Chicago. This trend is not about to end. Many American financial institutions are prime take-over targets, for example: UBS of Switzerland is looking to buy JP Morgan; ING Group of the Netherlands is looking at Lehman Brothers; Dresdner Bank of Germany is apparently interested in buying Paine Webber.

As the Committee is writing this report, Deutsche Bank, Germany's largest bank, is about to complete a take-over of Bankers Trust, the eighth-largest bank holding company in the United States. This transaction is valued at $9.7 billion US. At the same time, rumours in Europe suggest that French insurer Axa and American bank Chase Manhattan both see Barclays PLC, Britain's second largest bank, as a take-over candidate. GE Capital Services is negotiating to buy Long-Term Credit Bank of Japan Ltd. Swiss Re, the world's second-biggest life and health re-insurer, has just acquired Life Re Corp. of the United States for about $1.8 billion US.

According to a March 1998 report by two Bank of Canada economists profitability, not size, is the most important factor for the success of banks. According to Fortune magazine three of our big five banks, the Royal Bank, CIBC and the Bank of Montreal are among the top 15 profitable banks in the world and they're more profitable than five of the ten largest banks in the world.

Mr. Leo Broderick (Member of the Board of Directors, Council of Canadians)

A recently published report by the Bank of Canada argued that "many large financial institutions are turning themselves into large financial conglomerates by means of mergers, acquisitions, and strategic alliances, instead of continuing to operate as relatively specialized institutions. Some of the very largest institutions will try to become global financial conglomerates, offering all types of services to all types of customers in all or virtually all major financial centres. There is, however, probably room for only five to ten such global institutions world-wide. The rest will probably have to specialize in certain areas."[40] No one knows exactly where all this consolidation will lead the world financial services sector.

All of these recent and past mergers have presented public policy makers in other countries with the same dilemma that large-scale mergers would present in Canada. How can the desire to create strong and efficient domestic institutions through consolidation be reconciled with the desire to protect consumers and maintain competition? Public policy in many countries has evolved, with mergers, even very large ones, becoming more acceptable to governments. Switzerland and the Netherlands are notable examples of nations where governments have allowed mergers to take place so as to create truly large and international financial institutions. In Australia, the Financial System Inquiry

40 Charles Freedman, Clyde Goodlet, The Financial Services Sector: Past Changes and Future Prospects, Bank of Canada, technical report 82, p. 25

rejected the notion that large institutions should not be allowed to merge (the Australian equivalent of "big shall not buy big"). The government has, however, stated that mergers would not be allowed until competition was enhanced in the domestic market.

Even though these three nations are taking different approaches to mergers, their bank concentration ratios are not substantially different, and do not differ substantially from that found in Canada. Recent merger behaviour is not, therefore, the dominant determinant of bank concentration. Indeed, when we see concentration measures well outside of the Canadian norm, it is generally factors other than mergers that are important. A perfect example of this is the United States, where national concentration ratios are low simply because of the historical policy that prevented the creation of national banks.

Mergers and Acquisitions in Canada

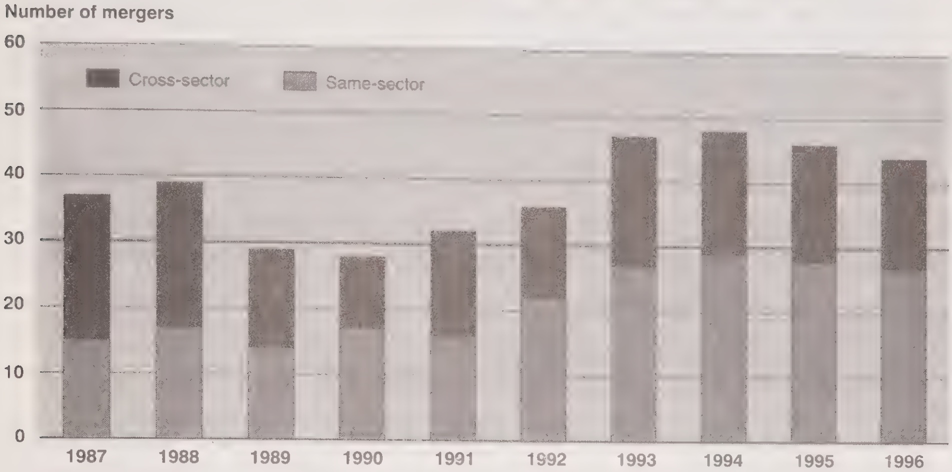
The banking and life insurance sectors in Canada are both highly concentrated in terms of market share, capital employed and profitability. The five largest banks account for over 85 percent of banking sector profits, and with the recent mergers in the life insurance sector, the five largest life insurance companies' share of the life sector's profits will likely begin to approach that of the five largest banks.

Canada cannot isolate itself from the effects of the world consolidation trend, nor can it isolate itself from the pressure to consolidate that financial institutions face. Instead, it is vital that regulators put in place a policy framework that will allow our financial services industry the freedom to make the best business decisions possible and take advantage of the best business opportunities that are consistent with the public interest. Canada's financial services sector is about to face major new consolidation, according to Edmund Clark, CEO of Canada Trust. He believes that ". . .some further consolidation is inevitable in Canada, and is in the public interest in order to ensure strong Canadian-based institutions."

The Canadian financial services sector has seen significant consolidation in the past. One need only look at the Canadian trust companies, brokerage services and life insurance companies to see the significance of this trend. There have been over 350

mergers and acquisitions in the Canadian financial services sector in the last 10 years. What is new with the two proposed mergers is the magnitude of the consolidation[41].

Mergers and Acquisitions in Canadian Financial Services, 1987-96



Source: The Conference Board of Canada, *The Canadian Financial Services Industry: The Year in Review, 1997 Edition.*

No Mandate to Examine Bank Mergers

The Committee's task in undertaking this study was clear. We did not have the mandate to examine the two proposed bank mergers per se, but to examine the recommendations contained in the MacKay Task Force Report. Many witnesses nevertheless tried to convince the Committee in favour of, or against, the proposed mergers. The merger issue could have skewed the consultation process and important recommendations would have been left by the wayside had the Committee succumbed to the pressure to address those proposed mergers.

Pro-merger witnesses referred to economies of scale (especially in the area of technology spending), economies of scope, reduction in costs through the elimination of overlapping networks, revenue gains from a broadened product range, the need for an increased capital base, the effects of increased

Let me also say outright that we support the bank mergers. We support them because we believe in free markets and we believe that size is important in today's global, financial markets. In many respects we wish it weren't so, but it is.

Mr. David Banks (Chairman, Newcourt Credit Group)

Canada can approve the proposed mergers and thereby give the bank and other financial institutions the ability to achieve the scale and the productivity they need to grow, to compete and to fund the nation-wide full-service, multiple-access banking system Canadians have always known.

Mr. Matthew Barrett (President and Chief Executive Officer, Bank of Montreal)

41 In January 1998, the Royal Bank of Canada and the Bank of Montreal announced their intention to merge. In April 1998, CIBC and TD Bank announced their own merger. As of October 31, 1997, the merged Royal Bank/Bank of Montreal, would have had assets exceeding $450 billion and shareholders equity reaching almost $20 billion. The TD/CIBC would have had assets totalling more than $410 billion with shareholders equity in excess of $17 billion.

First of all the bank mergers will kill jobs in our communities. If the bank mergers go ahead the banks already have flatly refused to protect jobs. We can look to the Americans to tell us what to do about bank mergers. In that country when banks merge, and quite recently up to 30% of employees were dismissed. If that happens in Canada tens of thousands of Canadians, and the industry is saying as many as 30,000 could lose their jobs.

Mr. Leo Broderick (Member of the Board of Directors, Council of Canadians)

The impact of bank consolidation in rural communities is uncertain. In the face of bank mergers, the American experience has been often a result and reduction in lending to local businesses.

Ms. Carol Rock (Executive Director, Women in Rural Economic Development)

Most research has concluded that economies of scale and scope are limited for large financial institutions. ...for a traditional large multi-product bank, efficiency gains from growth in size are limited. Neither were economies of scope found to be important; in fact, in some instances movement into new products was associated with cost increases.

In work prepared for the Task Force, a sample of 125 U.S. banks revealed no clear relationship between efficiency and size Neither did there appear to be much correlation between the size and efficiency of the six major Canadian banks.

A major challenge for our industry is that our productivity, which is measured as the ratio of our non-interest expenses to our revenues, is consistently worse than that of the best United States and international financial institutions and as the MacKay report points out, this difference has tended to widen in recent years. The reason is that our industry has increasing difficulty in funding the massive investment required by new technologies compounded by the continuing high costs of maintaining traditional bricks and mortar branch distribution networks alongside these new alternative channels.

Mr. Matthew Barrett (President and Chief Executive Officer, Bank of Montreal)

competition from monoline foreign banks, the ability to compete in global markets, the growth of stronger international competitors, and the possibility of lower prices and better service for consumers.

Merger opponents referred to reduced competition (translating into reduced services, limited choices, higher service charges, less lending to SMEs, the negative impact on small communities, and imminent branch closures), reduced employment and the increased concentration of economic power.

While the Committee resisted the pressure to debate the proposed mergers, the issues raised by witnesses are nevertheless the ones that will need to be addressed by any future review of consolidation proposals.

Mergers and the Impact of Greater Size

It is far from certain that size and efficiency are positively correlated. Larger multiple-line financial institutions might not be as innovative, flexible and responsive as smaller multi-line institutions or larger monoline financial services provider. As argued in the technical paper published by the Bank of Canada: ". . .the key issue may not be so much the size of financial services providers, but rather the nature of the activities they undertake"[42].

The evidence on economies of scale suggest that efficiency gains based on size are generally exhausted at asset levels well below those of the big Canadian banks, although smaller institutions such as credit unions clearly could still enjoy such economies through consolidation. But the argument that large institutions cannot achieve efficiency gains through mergers is not conclusive. As the Task Force argued ". . . the dynamics of today's business environment may be changing the relationships between size, costs and profitability"[43]. It is possible that the economic literature that fails to demonstrate economies of scale is based on data that does not take into account the factors that are relevant today and that will be relevant in the future. As the Governor of the Bank of Canada told the Committee, ". . .the evidence on this point

42 Charles Freedman, Clyde Goodlet, The Financial Services Sector: Past Changes and Future Prospects, Bank of Canada, technical report 82, p. 21

43 Task Force Report on the Future of the Canadian Financial Services Sector, *Competition, Competitiveness and the Public Interest*, Background paper no. 1, p. 128.

really doesn't allow you to come to a hard conclusion. . .yes there are economies of scale up to a certain point but after that we're just not sure. It's also true that a lot of the changes with respect to technology, at least the major ones, are quite recent and a lot of the analysis is looking at somewhat older information. So you don't want to be too adamant on the point but you can't go to the other side and say we can find economies of scale for megabanks."[44] This point is further developed in one of the Research Reports prepared for the Task Force. According Donald McFetridge, "the widely held and well documented view that there are no significant economies in banking is of U.S. origin and is drawn from a period in which banking technology (both product and process) was changing less rapidly. U.S. banks were limited in the ways they could expand and in the additional financial services or products they could offer."[45]

The evidence on the effects of mergers is inconclusive. The Committee believes that one should not just look at the state of the industry today and what consumers now demand. One should not rely too heavily on yesterday's data. Even the best academic analysis cannot capture the insight of market participants whose decisions require a vision of the future and an understanding of the challenges and opportunities that market forces present.

First of all, these mergers are not necessary, since Canada's major banks' studies show quite clearly, have already achieved the size necessary to achieve the kinds of economies of scale that could be useful in the banking sector. Moving beyond that is not necessary. The mergers are not helpful, because again, the empirical evidence doesn't support the contention that mergers will increase efficiency and reduce cost to consumers, nor will the mergers improve access to service.

Mr. Peter Bleyer (Executive Director, Council of Canadians)

Mergers should be judged in the context of tomorrow's expectations. The world is an ever changing market-place where what could be perceived today as contrary to the public good and the interest of the financial services sector could be essential to tomorrow's success.

The Public Interest: the Priority

Mergers and acquisitions are not ordinary business transactions and the financial services sector is not an ordinary industry. Mergers of large financial institutions could have profound economic implications. They can affect the overall safety and soundness of the Canadian financial sector and can affect the access to capital for certain segments of the economy.

44 House of Commons Standing Committee on Finance, Proceedings, 27 October, Issue 144, 20:15.

45 Donald G. McFetridge, "Competition Policy Issues", p. 89

Consolidation can mean new entrepreneurial opportunities for some and lost opportunities for others. In the long-run, it can mean better positioned financial institutions, able to successfully face global competitors and thus create jobs in Canada. On the other hand, they can also mean less competition in the domestic market. It is important, therefore, that a review process be in place to assess the effects that consolidation could have on our economic well-being.

The other road is to say no to mergers, to say big shall not buy big, to say our institutions are already big enough for Canada, and to rule out our competing effectively in world markets. Canadian financial institutions would also see their domestic shares dwindle, squaring off against much larger foreign-owned competitors. That would be a valid choice if your vision for Canada does not encompass excellence.

Mr. A. Charles Baillie (President and Chief Executive Officer, Toronto Dominion Bank)

The Task Force Report recognizes that consolidation is a legitimate business strategy. It recommended that mergers and acquisitions should not be automatically barred. Indeed, a number of the measures included in the Report are designed to promote and facilitate consolidation amongst financial institutions.

Recommendation 45 argues against the implicit "big shall not buy big" policy that has been in place since 1990. The Committee agrees that there should be no policy that automatically prevents large financial institutions from entering into business consolidations with other large institutions. Decisions to amalgamate or acquire should be viewed as legitimate business decisions. Earlier in this Report, we referred to the evidence that indicates rapid evolution in the sector. Financial service providers will have no choice but to adapt. How institutions adapt is a decision that they can best make. It is not up to governments to micro-manage financial institutions. It is, however, essential that government give priority to the protection the public interest. That interest is best protected by a rigorous and objective analysis.

The role of the government should be to review the public policy aspects of mergers and ensure that these restructuring initiatives are in the public interest; not to apply across-the-board policies that prejudge mergers and acquisition proposals. The "big shall not buy big" policy can lead to bad public policy choices, hence the Committee strongly supports recommendation 45.

If the government is concerned about excessive concentration resulting from the bank mergers it should seek a structural remedy such as divestitures, rather than seek to regulate prices and other terms of business. . .The more conditions such as price reductions are imposed as part of the merger approval process, the greater the investment of assets of the merging partners must be, in order to even out the playing field.

Mr. Edmund Clark (President, Canada Trust)

The Task Force Report recommends (see recommendation 46 to 52) a multi-step approval process for significant mergers. Such a process would include investigations by the Competition Bureau and the Office of the Superintendent of Financial Institutions.

The Competition Bureau is responsible for reviewing the impact on competition of a merger or a acquisition under the *Competition Act*. It could suggest remedies that would address any

concerns that the Bureau has. The Committee believes that this stage of the process should be co-operative and allow merger proponents to respond to the Bureau's concerns.

The Superintendent of Financial Institutions will also evaluate significant merger proposals, and report to the Minister of Finance any prudential consequences that might arise. The safety and soundness of our financial system is of the highest priority, and proposals should only be allowed if they pass this test. One of the factors OSFI should address is whether the "too big to fail" doctrine produces serious moral hazard problems. As with the Competition Bureau examination, we believe the Superintendent should be able to suggest remedies to alleviate his concerns and merger proponents should be able to respond to these remedies in a timely fashion. The Committee believes these two steps in the review process to be crucial elements that will guide the Minister of Finance. Competition, and safety and soundness are the most important elements in determining the public interest.

We urge substantial additional due diligence by the government. As the MacKay task force aptly observed, once a bank merger has been approved, it cannot be unwound. An important element of the due diligence process involves the task force recommendation that the Minister of Finance call for a public interest impact assessment from each merger proponent. CRBSC clearly urges that this step be taken.

Mr. Stephen Johns (President, Canadian Retail Building Supply Council)

If there are no competition or safety concerns, mergers and acquisitions should be approved unless demonstrated to be counter to the public good. The Task Force recommends a new step in the approval process: a public interest review. This third component would address broader public policy interest considerations. As part of that public process, merger proponents would be requested to produce a Public Interest Impact Assessment. Based on the evidence collected and analyzed, and after stakeholders have had an opportunity to make their representations, the Minister of Finance would decide whether or not to permit or reject a proposal.

Under this process, the Minister would approve a merger proposal only if he or she is of the opinion that competition in financial markets would not be adversely affected, that there are no safety and soundness concerns and that the transaction meets the broad public interest. The Task Force envisages the Minister having the legislative authority to obtain enforcement undertakings from merger proponents, including the power to impose sanctions for non-compliance with those undertakings. (See recommendation 52)

As part of the public interest assessment, the Task Force recommends that the Minister of Finance use a short list of criteria to assess the cost and benefits to Canadians and the industry.

These criteria would have to be addressed in the Public Impact Assessment that proponents produce. The Task Force recommends criteria such as the cost and benefits to consumers and to SMEs, regional impacts, international competitiveness, the employment impact, the adoption of innovative technologies, whether the transaction creates a precedent and any other public interest considerations deemed necessary by the Minister of Finance.

The Committee recommends one amendment to the criteria recommended by the Task Force. The Committee believes that the examination of employment effects should look at not just the short-term impact but also the long-term effect on employment. Moreover, employment should be evaluated not just in terms of the direct effect on the consolidating institutions but also in terms of the indirect effects it would have elsewhere in the economy. It is clearly in the public interest to consider the impact of a transaction on employment in Canada. But is it in the public interest to require that a merged institution have the same level of employment as the sum of the separate entities prior to consolidation? What if a trend to reduced unemployment is already in evidence? If the consolidation is expected to foster growth and innovation in the economy, leading to more and better-paid jobs for Canadians here and abroad, should it receive a failing mark because some restructuring takes place? And should the review process give strong weight to short-term effects, over longer-term effects?

The Committee believes that such an approach would be misguided. Indeed, it would be inconsistent with the whole idea of competition that the Task Force and the government endorse. Competition always leads to a certain amount of adjustment, as resources move from those sectors that fail to respond to consumer demands, to those that do. The transition of the Canadian economy from one based on natural resources to one based on knowledge also leads to a certain amount of dislocation. Free trade had the same result. It is this process that allows labour and capital to move to more productive uses.

The Committee agrees with the list of criteria recommended for the public interest assessment, as amended above. In fact, no witness identified missing criteria from the proposed short list, nor did any witness suggest that a particular criterion should be dropped.

As we said earlier, large-scale consolidation of financial institutions affects the public interest in a way that other consolidations do not. Hence a public review process is appropriate. It is extremely important, however, to clearly define the public interest.

At the start of this section we identified some of the motives that are fostering the consolidation movement in financial institutions around the world. The reader will likely disagree with several of them. Parliamentarians will likely feel some are without merit as well. But these are business decisions and it is up to the shareholders of financial institutions to judge the merits of those decisions. The government should get involved in the process when the public interest is at stake, with respect to competition, safety and soundness and the broader public interest criteria. While the line between business decisions and public policy concerns is sometimes blurred, it is extremely important that we avoid crossing it.

The Committee agrees with the recommended Public Interest Review Process. This process should apply only in the case of large financial institutions (i.e. where the merger involves institutions with more than $5 billion in equity or creates an institution with more than $5 billion in equity) or if otherwise considered necessary by the Minister of Finance. The Committee agrees that smaller transactions that pose little risk to the public good should be exempt from the review process. In addition, in the case of a failing financial institution, the expeditious completion of a transaction could safeguard the safety and soundness of our financial system. Hence, the Committee agrees that the Minister should be empowered, following a recommendation by OSFI, to rapidly approve a merger or acquisition proposal and avoid the recommended review process.

So our one recommendation is to make sure that there is a public impact statement that does not come, at best, from an institutional point of view but begins to ask the questions the customers are asking, the business customers are asking, the manufacturers and exporters, the retailers, other business customers are asking about what the impact of these mergers would be on their business.

Jayson Myers (Senior Vice-President and Chief Economist, Alliance of Manufacturers and Exporters)

As part of that review process, the Task Force recommends that merger proponents submit a detailed Public Interest Impact Assessment outlining their business plans and objectives, and identifying the public benefits and costs of the proposed transaction. The proponents would also have to indicate what steps they are prepared to undertake to mitigate undesirable effects of the transactions (e.g. commitments to SMEs, rural areas, divestitures, etc.). The Committee recommends that the government set out clearly what is expected from financial

institutions in terms of the information contained in the impact assessments. The Public Interest Review Process should assess mergers and acquisitions on a case by case basis.

To be successful, this process must be objective and co-operative. It must include third-parties not directly involved in a proposed transaction. Some have suggested that the public interest review process include public hearings. The Task Force did not make any recommendations in this regard.

The merger review framework must be an efficient process. We believe that the third step in this process should be required only after the first two steps have been successfully passed. This sequential approach should not delay the process. Once the Minister of Finance issues the appropriate guidelines, merger proponents would likely prepare a Public Impact Assessment as merger proposals are being developed. This sequential approach ensures that a potentially costly third step not be undertaken unless it is needed. In a business environment evolving rapidly, where consolidations take place regularly, unreasonable delays in the public policy decision process could mean lost opportunities. Hence the Committee recommends that the Bureau of Competition and OSFI render their decisions in a timely fashion after receiving an application. In Switzerland, for example, the Swiss Cartel Commission sets a timetable of 120 days. The Public Interest Review Process should also be undertaken expeditiously. Once the review process is completed, the Minister would be expected to render a decision quickly. A fast, effective, exhaustive, co-operative and transparent process will guarantee that the financial services sector is able to adapt rapidly to new realities and seize the best business opportunities. It will ensure that shareholders have the right to a rapid approval or rejection of a consolidation proposal. It will also provide Canadians with a mechanism to seek the best public policy choices.

The Minister of Finance will need clear authority and powers to accept and legally enforce, through the Governor in Council, undertakings from merger proponents. If these commitments are not met, the Task Force recommends sanctions be imposed for non-compliance with undertakings. The Committee agrees. But while sanctions are important, the Committee also believes that public disclosure by the Minister of any failure to comply, and the

expected public outrage that this would provoke, would act as an important deterrent to non-compliance. As in many other situations, exposure to sunlight is a potent antiseptic.

The Task Force made recommendations as to what the public interest assessment should examine, but it did not recommend how that process should be conducted. Will there be public hearings? Who will conduct them? Will it make use of expert testimony and analysis? These are important questions that need to be addressed and the Committee believes that a structured framework should be developed, within which this review will be conducted.

The Committee's recommendations regarding the Task Force's Merger Review Process are summarized below.

The Committee believes that mergers and acquisitions are a legitimate business strategy in the financial services sector as long as they are in the public interest.

The Committee recommends that there be a three-part merger review process in order to determine if consolidation proposals are in the public interest.

- Step 1 would require that the Competition Bureau be satisfied that any proposal does not violate the *Competition Act* and does not pose a threat to competition.

- Step 2 would require that the Superintendent of Financial Institutions be satisfied that any proposal poses no safety and soundness concerns.

The Committee recommends that remedial options be pursued actively and co-operatively with the consolidation proponents. These proponents should be able to respond in a timely fashion to any remedies put forward by the Competition Bureau or the Superintendent of Financial Institutions. Upon the successful completion of steps 1 and 2, the merger review process would proceed to the final step.

- Step 3 would comprise a Public Interest Review Process, including a Public Interest Impact Assessment. The Task Force recommended that the following specific elements be included in this assessment:

    - The costs and benefits to individual customers and SMEs.

- Regional impacts.
- International competitiveness.
- Employment, including both short run and long run effects as well as direct and indirect effects.
- The adoption of innovative technologies.
- Precedential impact.

The Committee recommends that the Minister of Finance issue guidelines that would describe how the review process is to work and make clear what is expected of consolidation proponents. The process should satisfy the following three criteria:

- It should be **transparent** so that the public can assess the benefits and costs of consolidation proposals.
- It should be **efficient** so as not to delay the approval process and impose undue costs and uncertainty on participants.
- It should be **co-operative** so that all parties work together to ensure a solution to the benefit of all Canadians.

The Committee endorses the Task Force view as to when step 3 would be required. Thus the Committee recommends that the Public Interest Review Process be required for all proposals that involve, or would create, institutions with more than $5 billion in equity. We further recommend that the Minister of Finance should also have the option of requiring a Public Interest Review Process for merger proposals involving smaller institutions. To ensure that the three objectives noted above are satisfied, it is important that the Minister issue guidelines so that financial institutions contemplating consolidation know precisely what is expected of them.

The Task Force recommended elements that should be considered in such a review but did not suggest how it should be conducted. The Committee believes that it is important to specify the mechanics of this process.

CHAPTER 5: REGULATION

As in other aspects of the financial services industry, Canada enjoys both advantages and disadvantages in the way its regulatory system has been structured. We have a stability that the United States does not. We have a history of reforms that have allowed the sector to develop in response to consumer demands, again unlike the United States. And Canada has developed a national financial services sector with a payments system that is the envy of the world. The development of a national banking market has benefited from the fact that banking is solely under federal jurisdiction.

Having worked for an American bank before and seeing regulators on both sides of the border, we can be proud of the level of regulation and the best practices adopted in this country.

Mr. John Cleghorn (Chairman and Chief Executive Officer, Royal Bank of Canada)

On the other hand, we have not been as open as the United States to new financial sector entrants and we suffer from a fragmented system of regulation of the securities industry. This fragmentation is problematic. Increasingly, the economy is turning directly to capital markets for the financing of business needs. As well, consumers are increasingly turning to those markets for savings opportunities. Here, the provinces are the regulators and a national market is still far from a reality. And as international co-operation becomes increasingly vital in a world of rapid globalization, the regulatory framework in Canada may be at a disadvantage. Our decentralised regulatory regime for investment securities makes our system expensive and fragmented. One can simply look at the recent take-over of Fonorola by Call-Net to understand how inefficient and conflicting securities regulations can be.

Clearly, with ten separate securities regulators in Canada and, indeed there are 12 if you count the securities regulators in the territories, there is concern about the potential for regulatory fragmentation of what is essentially one capital market.

Mr. David Brown (Chairman, Ontario Securities Commission)

For years there has been talk of a National Securities Commission, but the provinces have never been able to reach an agreement. The Committee was very pleased with the recent announcement of a new Canadian Securities Service where issuers will be able to submit prospectus filings, registrations of stockbrokers, insider trading reports and other documents that until now had to be filed with each provincial regulator. If successful this partnership initiative should benefit issuers and Canadian investors.

Rationale for Regulation

The primary reason for financial sector regulation has been the desire to ensure a safe and sound financial sector, both at the level of individual institutions and at the level of the sector as a whole.

Increasingly, the market conduct of institutions is also being regulated for the protection of individual consumers. This is due to the growing complexity of financial instruments and the need, therefore, to protect consumer interests.

Nevertheless, prudential regulation, i.e. that which is concerned with safety and soundness, is still the most prevalent type of regulation. It is designed to minimize systemic risk. Most consumers cannot adequately assess the solvency of the financial institutions with which they deal. Thus government plays a vital role as collective overseer of financial institutions and the financial system.

The economic rationale for prudential regulation is based on the existence of externalities in the financial services sector. If one institution suffers financial difficulties, that difficulty could be transmitted to other sound institutions via a general run from financial institutions. This is also called systemic risk. The traditional function of deposit-taking institutions has been to fund illiquid long-term assets (e.g. commercial loans) with very liquid short-term liabilities (e.g. demand deposits). If the failure of one institution leads depositors to withdraw funds from other institutions, their illiquidity could lead to their insolvency. A single troubled institution, especially if it is relatively large, could destabilize the entire sector, threaten the savings of Canadians and severely hamper the ability of the economy to function properly.

As this risk rests primarily with deposit-taking institutions, a system of deposit insurance was instituted three decades ago. This, in itself, is thought to assist in preventing systemic runs. But it has introduced its own set of new risks to the financial sector, namely the moral hazard that is created when depositors feel they have no need to be concerned about the financial state of the institutions with which they deal and when the management of those institutions try to exploit that situation by engaging in excessively risky lending and investment activities. As a result, regulatory authorities must engage in added prudential regulation to counter the effects of that moral hazard.

OSFI is the primary supervisor of banks and other federally incorporated financial institutions. It has responsibility for supervising all federally incorporated financial institutions. In addition, CDIC plays an indirect regulatory role through its

standards of business conduct. CDIC is a Crown corporation that insures deposits made by the public with banks and other deposit-taking institutions, both federal and provincial.

All deposit-taking institutions that are members pay premiums to cover CDIC's insurance obligations, although those obligations are guaranteed by the Government of Canada. In addition, CDIC has the power to borrow, if need arises, both from the Consolidated Revenue Fund (CRF) and from the private sector; any such loans are ultimately repaid by the premiums collected from member institutions.

The Forces of Change

The Canadian financial services sector was in the past characterized by the four "pillars" — banks, securities dealers, insurance companies and trust companies. Institutions carried on a limited range of activities and regulation was focussed on institutions.

The four pillars started to crumble in 1987, when the federal government allowed the financial institutions that it charters to own securities dealers. Major deposit-taking institutions have all taken advantage of this opportunity, and have done so in a very dramatic way.

That initial foray was followed by a profound and comprehensive change in 1992 when every federal financial institution was given the opportunity to own virtually any other kind of financial institution. In addition, the in-house powers of institutions were enhanced. As a result, any financial institution could offer the services of virtually any other institution, either in-house or via a subsidiary. Increasingly, Canadian financial institutions are conglomerates. The most extensive conglomerate groupings are those formed by the Schedule I banks.

The Task Force argues that the two features that will characterize the Canadian financial services sector in the future are accelerating convergence, which will blur the distinction between institutional types and their products, and the rapid evolution in technology which is allowing consumers to benefit from completely new services, and allowing them to access new and traditional services in completely new ways. This convergence is a world-wide

phenomenon. Consumers can now carry out banking, insurance and securities activities, and wealth management with one institution or corporate group.

Technology allows new products to be offered and business decisions to be made in better and more efficient ways. Telecommunications and computer technology allows products to be delivered in innovative ways. ATMs, telephones and the internet allow Canadians to undertake financial transactions 24 hours per day, 365 days per year, from any location in Canada and even around the world. Some institutions don't even have branches in Canada. Other institutions don't even operate, technically at least, within our borders.

New financial conglomerates, offering new and complex products, delivered electronically and instantaneously, are making it more difficult for regulators to do their job. The Task Force Report offers certain measures which would enhance the ability of OSFI to perform its duties more effectively in this new financial environment.

Starting on April 30, 1999, CDIC will have in place a risk-related premium regime. Some witnesses have argued against this new initiative because of its likely impact on smaller institutions and new entrants. Gerard Soloway of the Trust Companies Association of Canada said, "We believe that instead of encouraging a strong second tier, it goes the other way. It could harm the interest of smaller companies by making them less competitive. We believe the proposed system will in fact operate to assign the smaller institutions a higher risk rating."

Henri-Paul Rousseau of the Laurentian Bank used similar arguments. He told the Committee, "the precise objective of CDIC is to make sure if you're a newcomer or a small player, you bring competition. If. . .you are imposing through the premium system a lot of obstacles to growth, then you won't have the result you're looking for." This is a good thing. It is important, however, that the government not set up regulatory regimes that put one competitor at a disadvantage vis-à-vis another.

Just as the regulatory regime should not stifle competition, it should also not distort it. With increasing convergence in the financial sector, products and institutions are increasingly becoming direct rivals. The CLHIA argued that fifty per cent of the annual premiums of Canada's life and health insurers derive from

wealth accumulation protected by CompCorp. By contrast, banks and trusts companies now offer similar competing products in the wealth accumulation market that are protected by CDIC, a federal Crown corporation.

To the extent that regulation advantages one group of firms or products over others, it creates protective barriers which could have the effect of reducing the state of competition in the market. The Task Force believes that such an imbalance now exists between the consumer compensation programs that apply to customers of deposit-taking institutions and life insurance companies. Recommendations 12, 117 and 118 call for the amalgamation of CDIC and CompCorp. The Task Force does not specify which of the two options it prefers, a private-sector model or a Crown corporation model.

The Task Force and witnesses from the insurance sector see the current regime's imbalance stemming from the fact that consumers have more faith in the CDIC because of the fact that it is a Crown corporation that has access federal guarantees and the Consolidated Revenue Fund. The CLHIA argued that there is no question that the current inequities in consumer compensation arrangements create significant competitive disadvantages for life and health insurers relative to banks and trusts. The CLHIA presented a case study in their submission that summarized the decision by a trustee of a large pension plan ($125 million) to transfer management away from a large insurance company because CompCorp is backed only by the insurance industry, and not by the government. Surveys have consistently shown that consumers strongly prefer CDIC-backed products. The Committee heard testimony that it lost contracts to deposit-takers for the provision of savings products, only because the clients viewed the deposit-takers' products as protected by a better guarantee.

Savings products offered by deposit-taking institutions are perceived by consumers to enjoy a government guarantee while savings vehicles subject to CompCorp protection are not viewed this way. Since banks and life insurance companies offer directly competing savings vehicles, the asymmetry can have very real and unwarranted competitive effects.

The Committee also heard from CDIC that the products of insurance companies and deposit-takers are still sufficiently different so as to make amalgamation complex and possibly

What we are most pleased with, is the fact that for the first time in many, many moons, an institution which is associated with the federal government, has recognized the competitive inequities that exist in the financial services, including banks and insurance companies. . . These competitive inequities deal with deposit insurance and access to the payment system

M. Claude Garcia (président et directeur général, Compagnie d'assurance Standard Life)

The first issue I'd like to comment on is the question of the level competitive playing field. CompCorp fully supports consumers receiving the same level of government support in the event of an insolvency, regardless of the type of financial institution that fails.

Mr. Gordon M. Dunning (Executive Vice-President, Canadian Life and Health Insurance Compensation Corporation)

The Task Force proposes [revising CDIC and CompCorp] in the interest of two important public policy objectives: First, fairness between depositors and policyholders; and second, enhanced competition and competitiveness. Our industry strongly agrees with the task force. We therefore urge this committee to recommend that the government move forward promptly to develop and to adopt a specific approach for putting the plans on the same footing.

Mr. Chris McElvaine (Chairman, Canadian Life and Health Insurance Association Inc., President and CEO, Empire Life)

At a higher level, I think we need to consider payment system recommendations and CDIC recommendations with truly professional input. These are very complex issues and have enormous impact upon safety and soundness of the financial sector. I'm not arguing against them, I'm just saying they need some really good detail look into by the practitioners.

Mr. Peter Godsoe (Chairman and CEO, Bank of Nova Scotia)

We urge the committee to recommend acceptance of the level playing field proposal and further study of the most appropriate way to address this and the related issues of institutional and product conversion and consumer confusion. There are a number of models which could address these issues and we at CompCorp are anxious to participate in any such future discussions of the most appropriate solutions.

Mr. Alan E. Morson (President, Canadian Life and Health Insurance Compensation Corporation)

counter-productive. The Committee believes therefore that the federal government should give serious consideration to simply privatizing CDIC as a way of dealing with this concern. Gordon Dunning of the Canadian Life and Health Insurance Compensation Corporation argued that "While we do not advocate any particular level of government support, consideration of models that reduced government support would be entirely consistent with the direction of public and government attitudes".

This is obviously a very complex issue. The Committee supports the principle of the Task Force recommendations but believes that further study is needed. Hence we recommend that the government examine the best way to resolve this perceived inequity.

Prudential Regulation in a Modern Environment

The forces of change sweeping across the financial services industry have more of an impact than just challenging the ability of government policy to ensure a level regulatory playing field. It is having a profound effect on regulators who are concerned with the maintenance of safety and soundness in the financial sector. Financial institutions, both Canadian and foreign-based, are increasingly becoming multi-business, multi-product, internationally active financial conglomerates. It is hard for anyone but a specialist to understand many of the products and transactions that are part of an institution's menu. Only specialists can peer into the complex corporate structure of a modern institution to establish the nature and extent of risk. Canadian financial institutions are now global players, earning half of their income abroad. Canadian banks not only manage global risk, they must also manage the risks of their insurance, trust and securities subsidiaries. Large-scale transactions can take place instantaneously.

All of this makes it increasingly difficult for regulators to judge risk and threats to the solvency of an institution and the stability of the financial system. There may well be a tendency in such a situation to over-react by strict regulations that stifle entrepreneurial initiatives. This should be strenuously resisted. Rather, as the Task Force argues, "the challenge of modern prudential regulation is to find ways to supervise more innovative, entrepreneurial institutions effectively, without stifling the competition and dynamism that

come from innovation."[46] That sentiment is one that the Committee endorses. It is consistent with our earlier recommendation that the "one size fits all" approach to regulation be abandoned

An Expanded Role for OSFI

The Committee does not agree with the way in which the Report extends that sentiment by recommending that the mandate of OSFI be amended to explicitly require the Office to balance off safety and soundness concerns with the enhancement of competition, innovation, consumer protection and international competitiveness. Instead, we agree that the existing mandate, with the emphasis on safety and soundness, should remain, although its actions should not constrain competition. OSFI ". . .is required to fulfil its role with due regard to the effect on competition. . ." which helps to". . .resist the temptation of excessive regulation,"[47] according to John Palmer, the current Superintendent of Financial Institutions.

Mr. Palmer went on to express his opposition to these recommendations (recommendation 10 and 112) when he said that ". . .competition and innovation. . .are not matters within OSFI's control and may sometimes conflict with matters of safety and soundness. The addition of a specific responsibility for competition and innovation might put increased pressure on OSFI to exercise regulatory forbearance, to back off, if you like, to the detriment of early intervention and early resolution of problems."[48] Mr. Palmer went further ". . .[C]ombining matters of competition and innovation with OSFI's current mandate could make OSFI less independent and more vulnerable to pressure based on non-regulatory concerns. . . . If competition were a more important part of OSFI's mandate, OSFI might be placed under pressure to accept less than desirable owners of financial institutions." Michael Mackenzie, the former Superintendent of Financial Institutions, also shared our concern about broadening OSFI's mandate in this way.

It is proposed that [OSFI's] mandate would be modified to focus on competition and innovation as well as safety and soundness. Our industry has some concerns about this direction. The additional roles in promoting competition and innovation and enforcement of consumer protection could significantly divert OSFI's attention from the essential task of ensuring safety and soundness. OSFI's mandate would become more difficult and subject of greater ambiguity because of inherent tensions between safety and soundness and promotion of innovation.

Mr. Chris McElvaine (Chairman, Canadian Life and Health Insurance Association Inc., President and CEO, Empire Life)

The task force is seeking to achieve some important policy objectives including increased competition and enhanced consumer protection. However, recommendations to achieve these objectives could have an adverse affect of the government's ability to achieve other objectives including depositor and policy holder protection and high level of public confidence in the financial system.

Mr. John Palmer (Superintendent, Office of the Superintendent of Financial Institutions)

OSFI's duty is to interfere as little as possible with competition. We do not see this giving us the responsibility to actively facilitate competition. Instead, OSFI's overriding objectives currently are to safeguard depositors and policy holders from undue loss and to contribute to confidence in the financial system.

Mr. John Palmer (Superintendent, Office of the Superintendent of Financial Institutions)

46 "Improving the Regulatory Framework" Background Paper #5, p. 25.

47 House of Commons Standing Committee on Finance, Evidence and Proceedings, Issue 147, 29 October, 1998, 1835.

48 Ibid., 1840.

Enhancing competition and promoting competitive domestic institutions is a valid, and indeed important, goal of public policy. It should not be a goal of the prudential regulator, however. Just as the Bank of Canada has recognized that the pursuit of a single goal improves its functioning and makes monetary policy more transparent and hence more accountable to Canadians, so do we believe that OSFI should have a clear and non-contradictory mandate, namely, to ensure the safety and soundness of the financial sector and the institutions that comprise that sector.

In this way, any conflict between the two goals can be discussed and debated in public. If, for example, there is a general feeling that one goal is being excessively favoured at the expense of the other, that difference of opinion would be out in the open. The Superintendent of Financial Institutions and the Minister of Finance could appear before a Parliamentary Committee to explain the conflict. Differences would be more transparent and such transparency and public debate are unlikely to take place if the conflicting goals are resolved within a single organization, whether structured as it is at present or with a Board of Directors as proposed by the Task Force.

The MacKay Report proposes expanding the role of the Office of the Superintendent of Financial Institutions by adding a consumer protection component. I disagree with this recommendation as it would place OSFI in a position of conflict. The primary mission of OSFI is to ensure the security and soundness of the Canadian financial system.

Mr. Jean Roy (Professor of Finance, École des Hautes Études Commerciales - appearing in an individual capacity)

Expanding the role of OSFI to take on an enhanced role in consumer protection is also problematic. Again, the current and former Superintendents of Financial Institutions argued that it is not within the mindset of regulators to protect consumer interests and the potential for conflict also exists, although not to the extent it would if OSFI also had to promote competition. John Palmer argued the following: “Certainly, OSFI has a responsibility to protect policyholders’ interests, but how would OSFI best do so? By maintaining adequate levels of safety and soundness in the institutions, or by trying to advance particular consumer interests. It’s unclear which role takes precedent in the event of a conflict.”

As a result, the Committee opposes recommendations 10 and 112 in the Task Force Report. Instead, we recommend that a Consumer Protection Bureau (CPB) be established. The Committee is recommending that the new Financial Services Ombudsman be responsible for the CPB. The CPB would be responsible for all of the legislated consumer protection measures that are found in the MacKay Report. This is consistent with the Finance Committee’s recommendation in its October 1996 report, “1997 Review of Financial Sector Legislation: Proposals for

Change." The promotion of competition and innovation should represent a principle that is the basis for the government's financial sector policy in general.

With our recommendation for the creation of a Consumer Protection Bureau, we are not suggesting a lack of concern for the burden of regulation. We simply want all of the regulatory agencies to be assigned the appropriate objectives and mandate.

Streamlining Regulatory Processes

There are a variety of ways in which the burden of regulation can be reduced, to the benefit of consumers through enhanced competition, and to the benefit of institutions, via lower costs and enhanced competitiveness. We support the Task Force recommendations that streamline the approval process for new entrants (recommendation 4(b)). CDIC, as an insurer of deposits, has over time undertaken expanded regulatory duties. The Task Force recommended that all regulatory and supervisory functions should be centralized in OSFI and the Committee concurs. Grant Reuber of CDIC does not support this recommendation. He argues ". . . [R]emoving or reducing CDIC's role in reinforcing the safety and soundness of the [financial] system, would be inconsistent with CDIC's present mandate to minimize its risk of exposure for loss." The Committee believes that the portion of the CDIC mandate that requires it to promote sound business and financial standards for members overlaps with OSFI's rules. Thus CDIC's role in setting standards for business and financial practices should migrate to OSFI (recommendation 114). CDIC should be the insurer and undertake all of the initiatives that are appropriate to that role. Close co-operation between CDIC and OSFI is not only beneficial, it is expected. Again, if that co-operation is lacking, it is likely to become public and subject to Parliamentary scrutiny.

Governance of OSFI

Recommendation 113 proposes to create a Board of Directors for OSFI so as to improve its corporate governance. While the Superintendent expressed his support in principle for the recommendation, he also noted a concern that such a Board might undermine the powers of the Superintendent and the Minister of Finance, and adversely affect the accountability channels that run

from Superintendent to the Minister and from the Minister to Parliament. The Task Force report does not describe what the role of the board would be. As expressed by Jean Roy: "In the case of OSFI it will be important to be explicit about the respective roles of the Minister, the Superintendent and the proposed board." The Committee has major concerns in this respect and it recommends that the government not proceed with this recommendation at this time.

Intergovernmental Overlap

It would be. . .important to harmonize regulations on an interprovincial basis in order to reduce built-in administrative costs.

Mr. Jean-Guy Langelier, CEO of la Caisse centrale Desjardins, Confédération des caisses populaires et d'économies Desjardins du Québec)

The Committee supports the principle of recommendations 115 and 116, that are intended to reduce regulatory overlap and streamline regulatory procedures. As recommendation 115 deals with areas of jurisdictional authority, the Committee suggests that the federal government and OSFI work closely with their provincial counterparts to seek acceptable ways to resolve this regulatory overlap. If successful, this recommendation will bring some synergies and less duplication in the regulatory regimes. Yvon Charest from L'Industrielle Alliance was very clear "Within our corporation, L'Industrielle-Alliance, we have companies incorporated in Quebec and companies incorporated under a federal charter . . . Even though the parent company of the group is incorporated in Quebec, we must still provide financial information to the federal regulatory body on a regular basis. If there was a system based on respect for principal jurisdictions, we would not have to deal with two separate oversight authorities."

Regulating New Entrants Without a Physical Presence

The Task Force also dealt with a regulatory issue that will increasingly pose difficulties for domestic regulators, namely how to deal with institutions that offer services to Canadians without establishing a physical presence in Canada. This is not a new issue. Large Canadian corporations have long had dealings directly with foreign institutions. Some Canadian travellers maintain banking relationships in Canada and abroad. Residents near the American border deal with American banks in such cities as Buffalo, New York. The entry of Wells Fargo into the Canadian market, however, represents a completely new scope of access to the services of

such institutions in the future. And with the further development of internet transactions, Canadians will, in a sense, be able to shop the world for financial services. They will be attracted not just by mass mailings but by internet promotions. Internet search engines will be like the Yellow Pages, directing consumers to web sites such as www.cheapestmortgage.com or www.freechequing.com. What kind of regulatory protection can they expect? What should they expect?

At present there is no coherent regulatory and legislative framework that would apply to firms entering the Canadian market without a physical presence. The provisions of the Bank Act apply only to financial institutions operating in Canada with a physical presence. Those that do not, are subject to no legislative or regulatory rules of the federal government. Indeed, the Wells Fargo case involves one in which that financial institution went out of its way to guarantee undertakings as required by the Superintendent of Financial Institutions. As the Task Force noted, the undertakings responded to no prudential concerns, nor did they make any business sense. They were merely intended to promote the claim that the bank was not doing banking business in Canada.

In such a world, what should we regulate and how can we effect that regulation? The Task Force concludes that foreign, virtual entry into a market can only be regulated satisfactorily by an international agreement that would set common rules and assign enforcement to the home regulator. In the meantime, it recommends a number of interim solutions such as a certification system for foreign lenders who engage in mass solicitation, and ways in which consumers can be kept informed about foreign providers. This certification process, is a way of ensuring that foreign financial companies dealing with Canadians respect Canadian market conduct regulation. How effective it would be remains to be seen.

As the Task Force notes, foreign institutions without a physical presence in Canada who take deposits from Canadians represent a much greater concern for regulators and public policy makers. This is clearly not something that can be resolved unilaterally, and the Task Force argues that Canada should be active at the international level in encouraging a common approach to this challenge. It suggests regulation by the home jurisdiction. The Task Force

recommended that, until the needed international arrangements are in place, OSFI should step up its information disclosure operations that are currently provided via the internet.

We do believe there are concrete initiatives that the government can undertake now and that could address many of the concerns expressed in the Report. The Committee recommends that the federal government enter into negotiations, starting with the United States, to provide national treatment to customers of financial institutions. Thus Canadian residents who make deposits in American banks would have all the benefits of American residents. Canadian resident borrowers would enjoy all the regulatory protections of American resident borrowers. The same would apply to American residents dealing with Canadian banks. If Citicorp decided to supply a full range of financial services to Canadians over the internet, from a location in the United States, Canadians would enjoy the same consumer and deposit insurance[49] protections as American residents who deal with Citicorp.

49 At present, deposit insurance is typically limited to deposit accounts denominated in local currency. Thus American dollar accounts in Canadian banks do not enjoy a CDIC guarantee and Canadian dollar accounts in American banks do not enjoy FDIC guarantees.

CHAPTER 6: CONSUMER EMPOWERMENT

There are two ways one can protect consumers: enhancing competition and legislating against undesirable anti-competitive behaviour.

Competition can be seen as the ultimate guarantor of consumer protection. When in place, many of the Task Force's recommendations endorsed by this Committee will provide greater choices to consumers. Competition amongst many firms offers consumers the widest range of choice and the best products at the lowest prices. And with more choice comes increased mobility so consumers who feel badly served by a particular supplier can easily move to another who will treat the consumer fairly and properly. If competitive forces worked perfectly well there would be no need to legislate business behaviour since consumers would simply move to another supplier.

But, we now live in a very complex business environment where competitive forces are not always present. Consumers cannot always easily exercise all their choices either because of dominant players and abusive commercial practices or, more frequently, because of lack of information.

[The Task Force report] makes it clear that financial institutions will only serve all Canadians fairly and well if consumers are empowered, if disclosure and transparency rules are strict and comprehensive, there is a comprehensive accountability system enacted and it also makes it clear that financial institutions, especially banks, must serve all stakeholders fairly and well because they have benefited historically from regulatory protections and they also provide essential services to Canadians

Mr. Duff Conacher (Chair, Canadian Community Reinvestment Coalition, and Co-ordinator, Democracy Watch)

Consumer choices are more and more difficult to make because financial products are complex and sometimes offer unique characteristics. These characteristics make financial products difficult to compare. One just has to look at the difficulty in comparing the wide variety of credit cards offered to us to understand how sophisticated and innovative financial products make our choices as consumers more difficult. This difficulty is enhanced by new technology that translates into more choices. Many customers will still shop around and select their financial products from more than one financial institution. Many others however will take advantage of bundled financial services. Financial institutions are increasingly aiming at building a total customer relationship with their clients. This means that, not only do deposit-taking institutions want to offer customers chequing and savings accounts, they want to offer credit cards, RRSPs, life insurance, brokerage and wealth management services. To do this, these financial institutions use a wide assortment of incentives and compensation (lower fees, lower interest rates on loans, higher

return on savings products. . .). In these circumstances, consumers' choices become difficult to assess and difficult to act upon. Unless they get the information needed to make wise choices, unless personal information is protected against abuse, unless there are strict rules against coercive tied selling, unless they can freely move from one institution to another, many consumers could eventually make wrong decisions.

Coercive Tied Selling

The Competition Bureau has the task of examining the behaviour of firms, in the financial services sector and other industries, to ensure that company behaviour does not have an adverse impact on the state of competition in the sector under question. Competition policy, however, is aimed at the macro level. It cannot guarantee that individual customers will never face abusive practices nor can it guarantee that such practices are rare occurrences. Instead it attempts to ensure that restrictive trade practices such as refusal to deal, tied selling, market restriction or abuse of dominant position do not enable firms to exploit market power.

The limitation of the Competition Act was made apparent to the Committee in the spring of 1998 when we were investigating tied selling — the Committee ultimately recommended that section 459.1 of the Bank Act should be enacted into law. The Competition Act, while an important tool, was clearly inadequate for the purposes of protecting individual consumers from abusive practices. This view was shared by the Task Force Report. Indeed, that Report went even further, arguing that more than the Competition Act is needed to promote an environment of competition in the modern financial marketplace.

Canadians also appear to be concerned about the terms and conditions of their financial contracts. A surprisingly high percentage of Canadians (16 percent) reported feeling that their loan or mortgage might not have been approved if they had not purchased another product from the same institution.

As we discovered last Spring, and corroborated in the Task Force Report, tied selling has become one of the more prominent concerns of financial sector customers and financial services providers. Tied selling is the process by which one product may be purchased only in combination with another product.

There are instances in which tied selling may be beneficial and acceptable to consumers. In some cases the link is due to the technological nature of the products or because of consumer demand. In addition, there are instances of beneficial cross selling

or bundling, in which products may be purchased individually or in packages, with the package price being less than the sum of the individual prices. Because of the convergence taking place in the financial services sector, institutions are increasingly bundling their services. This type of packaging is usually beneficial to consumers.

[T]he most severe anti-tied selling regime in the world will have limited impact if Canadian consumers continue to feel powerless sitting across the desk from a bank loan officer.

Mr. David Thibaudeau (Canadian Association of Insurance and Financial Advisors)

As we learned during our earlier hearings, and as we are learning during these current hearings, what concerns Canadians about this practice is the potential coercive aspect. Coercion is about unequal power in financial relationships and this must be mitigated against, especially if financial institutions become more like conglomerates. Not only do such practices abuse consumers, but they may well have the effect of diminishing competition. Consumers cannot easily respond through the market to abusive practices. It is not simple or costless to move financial business from one institution to another. Realising this, financial conglomerates could use their leverage to draw a wide variety of business to themselves.

The other realisation that has become apparent to the Committee is the fact that tied selling is as much about perception as it is about reality. To the extent that it consequently affects behaviour, leading to a lessening of competition, it is clear that measures should be taken to address the perception as well as the reality

The Task Force makes four recommendations in this regard. Section 459.1 of the Bank Act that was recently proclaimed into law on the advice of this Committee should be expanded to apply to all federal financial institutions and expanded to apply to a broader range of financial services that might be tied together. This extension should be undertaken quickly, according to the Task Force. In addition, consumers entering into an agreement covered under the new provisions must be notified that any coercive behaviour of the institution is against the law and they must be informed as to what actions would constitute coercive tied selling. Finally, the Report recommends the establishment of a redress mechanism with civil remedies.

The Committee supports recommendations 70 to 75 as a result.

Other Consumer Empowerment Measures

In addition to forbidding certain behaviour, consumers must be given the tools necessary to exercise and protect their rights. Empowered consumers are an important prerequisite for competition. As noted earlier, competition also helps to make financial institutions more competitive. Competition is not just about the number of suppliers in a market, nor is it only about concentration ratios. Competition is about behaviour. To have market competition requires that all participants in a market behave in a way that is consistent with competition, and in a way that fosters competition. A market works well when participants have choices, for example, when consumers are willing and able to walk away from bad suppliers. Thus policies that empower consumers can have a wide-ranging impact on the look of the financial services sector in Canada. In this regard, consumer empowerment measures, if designed properly and if effective can greatly benefit the economy.

The Task Force recommends a series of measures designed to help consumers have more choices and more power to exercise these choices.

Disclosure and Transparency

Clear customer documentation must bridge the gap between the demise of the tangible paper product and the cyber-world we live in.

Ms. Rozanne E. Reszel (President and CEO from the Canadian Investor Protection Fund

Sixty-four percent of Canadians think they are not receiving enough information about the banking products they are purchasing. The number is similar (68 percent) for products bought from insurance companies.

As the Task Force reports, for consumers to properly play their role, they must be able to discern a good product from a bad one and a good institution from a bad one. This is a prerequisite but it is clearly not sufficient. Indeed, it is quite a challenge given the nature of many financial products and the way in which transactions are undertaken. They are complex services, often purchased infrequently and subject to inertia on account of moving costs. In such circumstances, financial institutions might perceive only minimal costs as a result of bad customer treatment.

A smart consumer is an aware consumer. For that to be the case, the consumer must understand the products that are being offered and the terms at which those products are offered. In other words, transactions must be characterised by transparency. Information must not only be disclosed, it must be disclosed in a manner that consumers can readily understand.

New disclosure and transparency rules would allow consumers to understand what is offered to them and at what price and conditions. Plain language is essential in this regard. One must avoid unreadable language and technical jargon. One prerequisite of transparency is timely disclosure of the terms of a financial contract. Financial services are nebulous products and it is not until consumers know full well the terms and conditions of their financial contracts that they know what they are actually buying. Anyone who recently signed a mortgage contract understands what we are talking about. Very few of us could explain the pre-payment penalties on a closed mortgage if asked to.

While the complexity of prospectus disclosure for retail investors is currently the subject of review specifically as it relates to mutual funds, customers need clear and complete information to make informed decisions. Certainly the recommendations in number 57 concerning clear and simple English legal documentation is one we would whole-heartedly endorse.

Ms. Rozanne E. Reszel (President and CEO from the Canadian Investor Protection Fund)

The Committee endorses the recommendation 57 to 60 contained in the Task Force Report in this regard.

The Committee does not believe OSFI should be responsible at the federal level for enforcing transparency and disclosure requirements. In fact, as discussed elsewhere in this Report, there could exist a clear conflict with OSFI's main mandate of promoting safety and soundness of our financial service sector if the Superintendent was also given the mandate to promote innovation, consumer protection and competition as proposed in recommendation 112 b) of the Task Force. The Committee believes this responsibility should be given to the new Consumer Protection Bureau under the responsibility of the new Financial Services Ombudsman. Hence the Committee cannot endorse recommendation 61 as presented.

The Committee also expresses caution with respect to recommendation 62, related to the disclosure of fees and commissions paid to employees or third parties. A few witnesses argued against the Task Force's proposal. For example, Mario Georgiev (Optimum réassurance) argued that ". . .the Task Force goes too far in its recommendations especially with regard to the disclosure of fees and commissions in respect of any financial services transactions". The Committee believes that financial institutions should only disclose the type of compensation, salary, bonus and fees given to employees or agents. The Committee is of the opinion that to disclose fees and compensation paid would not help consumers make better and informed choices. In fact, has argued by the CLHIA, in their submission to the Committee: "The best approach. . . is to ensure that the full cost of the product is clearly disclosed in advance. It is useful for the consumer to know whether the intermediary receives a fee, a commission, salary or

bonus . . . for the transaction. Moving beyond this to attempt to prescribe disclosing how the distribution charges are allocated along a given distribution channel can be literally impossible and has significant potential to mislead customers”

Finally, the committee rejects recommendation 63. If acted upon, the statutory prohibition of unilateral amendment in consumer contracts could be detrimental to consumers. First it is quite legitimate for firms to review on a regular basis, their price structure and the range of services that are offered. One cannot expect any business to freeze its prices unless consumers consent to an increase. Secondly, unilateral amendments are not necessarily negative. One could imagine new services (for example, smart cards or PC banking) offered at no extra charge as part of an already agreed to service package. What is important is not banning unilateral contract amendments but making sure that the changes are fully disclosed and in a timely manner. As recommended by the Task Force in recommendations 57 to 60, helping consumers to make the best decisions.

Protection of Personal Privacy

Canadians have strong concerns about privacy but are split on whether their privacy rights are adequately protected.

Privacy is a unique issue because, as the Task Force notes, it almost constitutes the status of a human right. But it also an economic right in the sense that it defines the ability of individuals to determine what type of relationship they want to have with a financial institution. The financial services sector is evolving rapidly and becoming more and more integrated. As new financial products are introduced, as information technology becomes omnipresent, the risk of abuse of personal information is multiplied. As the Task Force argues “[w]ith an increase in both opportunities and incentive to abuse personal information by using it in ways the donor did not intend, it will be important to have high standards of behaviour to preserve the integrity of the relationship between customer and institution”[50]. The Committee agrees with this observation.

Theoretically, you can create separate computer files and argue that employees selling insurance will be physically separated from other employees of the financial institution. You can erect all kinds of barriers. However, in practice, in a bank branch, there may be 10 employees, two of whom sell insurance and must meet sales targets. These employees have lunch and spend eight hours of the day together. Despite the fact that theoretically, these functions will be separate, there is no way of being certain that personal information will really remain confidential.

M. Yvon Charest (vice-président exécutif, chef, Exploitation, Industrielle Alliance)

Canada has a wide ranging privacy environment. The financial sector has now established a variety of sector-specific privacy codes. Quebec has now enacted privacy legislation that is very broad and extensive.

50 Task Force Report. p. 130

The Committee strongly supports the government's initiative to legislate standards for the collection, use and protection of personal information. Bill C-54, entitled *Personal Information Protection and Electronic Documents Act,* if enacted, will provide Canadians with right of privacy with respect to their personal information that is collected, used or disclosed. This legislation will initially apply to federally-regulated corporations. The privacy provisions are based on the 10 principles of the CSA's Model Code for the Protection of Personal Information. Bill C-54 should be expeditiously adopted by Parliament. Hence the Committee endorses recommendation 64, 68 and 69.

378.The Task Force recommends that the financial sector be required to develop further binding sectoral codes that would be consistent with the legislated standards, but that would go beyond them (see recommendations 65 to 67). The Committee endorses the thrust of these recommendations. The Committee wishes to remind the government that OSFI should not be given the mandate to certify the codes of conduct and ensure that compliance is audited (as stated in recommendation 66). The new Consumer Protection Bureau of the new Financial Services Ombudsman should be given this responsibility.

We believe that the basic minimum standards articulated are not onerous and indeed protect the privacy rights of individual Canadians

Mr.Walter Robinson (Canadian Taxpayers' Federation)

[B]efore you give more powers to the bank, let's make sure that the banks obey the laws of this country, respect the privacy of consumers and respect the consumer by not forcing them to buy other products

M. Claude Garcia (président et directeur général, Compagnie d'assurance Standard Life)

On privacy and consumer issues I personally concur with and strongly support all the recommendations on empowering consumers. The banks are in a tremendous position of power and influence over their customers, and should be kept a strict accountability with how these use or abuse that power.

Mr. Christopher Moon (Barrister and Solicitor, Davis Webb Schulze & Moon)

Financial Sector Ombudsman

In 1996, the Canadian chartered banks put in place a Canadian Banking Ombudsman. Its power was expanded in 1997 to include personal banking customers. Participation by the banks in the CBO is voluntary and at present 12 banks are members. Bank appointed ombudsmen in each bank complement the CBO. A customer's first recourse is to the ombudsman within the institution; failing satisfaction, the customer may appeal to the CBO. The life insurance industry has also put in place an ombudsman process similar to the banks' redress process.

The Committee agrees with the Task Force and supports the recommendations (see recommendations 76 to 80) that a Financial Sector Ombudsman be established by legislation. It could act as a mediator and conciliator of consumer grievances with any federal financial institution, not just the banks. It would be independent of industry participants. If provinces agreed, the Ombudsman could act for both federally and provincially regulated financial institutions. It is believed this could substantially limit consumer

[O]ur submission strongly supports the need for a federal ombudsman of financial services, somebody that would operate independently of the current regime of bank ombudsman.

Mr. Stephen Johns (President, Canadian Retail Building Supply Council)

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Mr. Stephen Johns (President, Canadian Retail Building Supply Council)

Secondly, the report suggests that the role of the Canadian Banking Ombudsman be expanded to cover all financial services. I fully endorse this recommendation. Furthermore, I believe that the role of the Ombudsman should also be expanded to cover all consumer protection issues, and not simply the resolution of individual problems. I recommend that the Ombudsman be responsible for issues related to the transparency of contracts and standards of access to financial services

Mr. Jean Roy (Professor of Finance, École des Hautes Études Commerciales) appearing in an individual capacity)

confusion and ease access to the redress mechanism. A consumer who purchased life insurance from a trust's subsidiary and who wants to file a complaint should not have to figure out which redress channel is the appropriate one. To integrate all the complaint mechanisms under a single office for consumers would be an important step in the right direction.

Jean Roy argued that "the role of the Ombudsman should also be expanded to cover all consumer protection issues, and not simply the resolution of individual problems." The Committee strongly agrees with this statement. Hence, in respect of his/her mandate, the Committee recommends that the new Ombudsman be given the responsibility of promoting consumer protection issues and of auditing compliance. That office should also be responsible for the newly-created Consumer Protection Bureau.

Consumer Organisations

The Task Force recommends the establishment of a Financial Consumers Organisation. It believes an advocacy group could help make consumers more vigilant. The Committee believes this would be beneficial but we do not believe it should be funded by the government. Instead, we believe that Industry Canada should study the various models that are available to provide funding for such organizations, including the distribution of information related to consumer advocacy groups, through mailing inserts.

Finally, the Committee agrees with the Task Force recommendations related to proficiency standards (recommendations 81 to 86). As the role of financial intermediary evolves, the concept of a single regulator harmonising the proficiency standards across all jurisdictions becomes more appealing. The province of Quebec has already moved in that direction.

In conclusion the Committee wants to reiterate that one of the challenges facing our government is how to empower consumers in a world of rapid evolution. One has to be extremely careful to do so without overburdening the financial services sector or stifling its ability to adapt to changing realities when acting on recommendations 53 to 55. A delicate balance must be found since constrictive regulation could diminish competition and competitiveness.

CHAPTER 7: CORPORATE CONDUCT AND CANADIANS EXPECTATIONS

Every day, customers of financial institutions undertake millions of financial transactions: from renewing a small business line of credit to depositing a cheque in an ATM, from paying a bill to making a night deposit, from buying foreign currencies to making a direct payment at the grocery store.

Every day, millions of Canadians find themselves to be well served, at reasonable prices, having access to a wide range of services. According to data presented to the Task Force, 91% of bank users are satisfied and 2/3 of them had never switched financial institutions in the past 5 years.[51] Average monthly fees are substantially below those imposed in the United States or Sweden for example.[52] Canadian consumers have comparatively lower interest rate spreads on personal loans and mortgages.[53]

All these satisfactory results can be challenged using anecdotal evidence or other data. The Committee has heard many times that many low-income Canadians have difficulty in accessing basic financial services and that many small and medium-sized entrepreneurs do not have ready access to financing. In surveys produced for the Task Force, it has been shown that only 29% thought that the quality of service provided by banks was very good to excellent.[54] Other data show that 44% of bank users think that service charges are unfair.[55] Credit card spreads are higher in Canada than in the United States.[56]

There are, undoubtedly, areas in which corporate conduct is considered failing and consumers' expectations are not met. This is why the Task Force recommended measures to deal with the

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51 See McKinsey and Company, The Changing Landscape for Canadian Financial Services, September 1998, Exhibits 6.33, 6.34.

52 Ibid, Exhibit 6.25

53 Ibid, Exhibit 6.20, 6.21

54 Ibid, Exhibit 6.32

55 Ibid, Exhibit 6.23

56 Ibid, Exhibit 6.22

difficulties that many Canadians face in their daily dealings with financial institutions. The Committee believes the financial services sector should be subject to higher expectations than are other sectors of the economy. It must meet the needs of small businesses (including the very small) and of firms engaged in the risky, knowledge-based technology sector. The Committee also believes it is important for all Canadians to have access to a wide choice of quality financial services, priced at reasonable levels.

These corporate obligations can be justified by the fact that financial institutions play a special role in our economy. The financial services sector is no ordinary industry and that has been recognized by government policy measures over the years.[57] The Committee wishes to make clear, however, that financial institutions are not public utilities that should have a wide range of their business activities regulated. They are not natural monopolies the way many public utilities were in the past. They operate in an environment that subjects them to competition. Furthermore it is the intent of this Committee, just as it was the intent of the Task Force, to enhance competition in the marketplace. Public utility regulation is completely inconsistent with such a focus on competition.

Business Financing

The Task Force makes several important recommendations regarding the financing of small and medium-sized enterprises, the knowledge-based industry and aboriginal businesses.

SMEs play an important role in our economy: 75% of Canadian businesses have less than 5 employees and 97% of all businesses have fewer than 50 employees. It has been shown that very small firms have been the most consistent source of job creation over the last 10 years. In 1996, 87% of new jobs were attributed to this sector. SMEs represent more than half of private sector employment and account for 43% of our GDP.

In 1933 and 1964 credit unions and caisses populaires had an insignificant share of small business financing, and in 1996 accounted for almost 15 percent of SME business debt financing.

57 It has been argued that measures such as restrictive foreign bank entry policies, deposit insurance, access to liquidity support from the Bank of Canada, wide-ownership policy have meant special privileges granted to the banking industry.

Banks hold 38% of total business credit. Of all business loans, banks dominate the market with 84%.[58] Of all the business banking services, small and medium commercial lending is among the most profitable. It is estimated that in 1997, lending to SMEs generated $1.3 billion in profit and a return on equity between 10 and 15 percent.

Specialized financing companies have recently experienced rapid growth and now hold about 16 percent of the SME debt financing market, up from just 9 percent in 1994.

Banks have tried, and are still trying, to address SME's concerns about accessibility to capital. New initiatives aimed not only at SMEs but also at knowledge-based industries have been put in place. The Bank of Montreal offers $50,000 unsecured credit with 24-hour turnaround, CIBC : $15,000 to $100,000 loans at prime less 1%, TD Bank has 13 specialized knowledge-based industry banking centres and offers an Advanced Technology Loan Program, the Royal Bank has knowledge-based industry specialists and a Small Business Venture Fund, Scotiabank has a $50 million Loan Program for Innovation and Growth Sector. While the Committee agrees that important steps have been taken, more should be done.

In fact, the Committee was told on numerous occasions that financial institutions may not be serving SMEs properly. The main concern usually relates to access to bank financing and access to capital in general, including equity financing.[59] Evidence seems to indicate that there is a gap not properly filled by traditional Canadian financial institutions. One can look at the myriad of federal and provincial programs put in place to finance SMEs to realise the importance of financing needs not filled by the private sector. At the federal level alone, one can find a very long list of

58 Ibid, Exhibit 2.27

59 Beside access to credit, the other concerns relate to account manager turnover and pricing of financial services: 60% of respondents in a recent CFIB study reported that they have had more than one account manager in the past 3 years.

policy initiatives.[60] The government and the financial services sector should be in a position to better assess small business financial needs.

Recently, the arrival of Wells Fargo also signalled the fact that a part of the market was not being adequately served. This San Francisco based financial institution is able to offer quality and responsive services to Canadian SMEs using a unique risk assessment model. Credit scoring allows it to assess very short loan applications within 15 minutes. Using direct marketing. Wells Fargo is presently offering pre-approved lines of credit not exceeding $50,000.

Beside anecdotal evidence, there is no concrete proof that could be used to properly assess the SMEs' difficulties in securing credit. There is a consensus that SMEs are less likely than larger firms to apply for financing, more likely to provide security for their loans, to pay higher interest rates and to be turned down on loan applications more frequently, but as the Task Force observed, there is a lack of adequate data to support the establishment of solid policy initiatives. Hence the Committee supports recommendations 101, 105 and 106 that are designed specifically to bridge this information gap.

Relationship Banking and SMEs

The relationships between SMEs and their banks are less than optimal. As mentioned in the Task Force Report, loan officers are asked to administer a large volume of borrowers and handle a large caseload of new loan applicants. Because of the career path imposed by the banks' culture, loan officers are often asked to move to other branches or other services. A recent survey showed that 60% of SMEs had more than one account manager in the past 3 years. The Committee believes that this type of rapid turnover in

60 Small Business Loans Act, Business Development Bank of Canada, Financing support through the Regional Economic Development Agencies (ACOA, WEDC, Canada Economic Development for Quebec) and the Federal Economic Development Initiative for Northern Ontario, Community Futures Development Corporations, Canada Community Investment Plan, Source of Financing, Farm Credit Corporation, Financing Assistance for Canadian Cultural Organisations, Aboriginal Business Canada, Community Economic Development Program, Commercial Development Program, Resources Access Negotiations Program, First Nations and Youth Business Program and generous tax incentives such as SRED tax credit and LSVCC.

account managers results in the inability of SMEs to build a strong and personal banking relationship. Thus Committee agrees with recommendation 102.

When appearing before the Committee, the Chairman and CEO of the Royal Bank of Canada announced the establishment of a new bank subsidiary to better served SMEs. The Committee can only support such initiatives that, if successful, will foster stronger relationships between borrowers and their financial institutions. It should also decentralise credit-granting authority as recommended in recommendation 103 in the Task Force Report.

Most SME loans in Canada are priced between prime and prime plus 3 percent, with an average of prime plus 1.75 percent. In the United States, this range is much broader, and loans can be priced anywhere from prime to prime plus 8 percent, with an average of prime plus 3.25 percent. The narrower range in Canada may imply that Canadian banks are not adequately pricing for risk, which may have implications for SME accessibility.

In addition to the way in which the bank hierarchy operates, their attitude towards risk also adversely affects access to capital by SMEs. Small businesses are usually granted loans at 3% above prime. The problem was clearly summarised by Terry Norman from the Metropolitan Halifax Chamber of Commerce: "If the loan is considered higher risk it is declined rather than approving it at a higher spread as is common practice in the United States". This is why, small business owners are sometimes forced to use personal credit cards or mortgage their principle residence to find the necessary financing. Wells Fargo, on the other hand, is presently offering loans at prime plus 8% and finding willing takers. Instead of denying credit to those borrowers who would be willing to pay the appropriate risk premium, Canadian financial institutions should be encouraged to serve this market via appropriately priced loans. The Committee endorses recommendation 104 which promotes this.

MacKay [recommends] that lenders should be prepared to make available more innovative financing packages with appropriate pricing for high risk borrowers who may now be denied financing. In my experience this is a somewhat naive statement. In most high risk cases there is no appropriate pricing that will cover the loss ratio and cost of administration.

Mr. Christopher Moon (Barrister and Solicitor, Davis Webb Schulze & Moon)

Knowledge-Based Industries

Rapid technological advances are changing the Canadian economy. We are shifting from a resource-based economy to a brain-based economy where knowledge will be the key to our success as a nation that provides a high-standard of living. Skills, innovation, invention, technology, research and development and entrepreneurship fuel the new economy. A knowledge-based industry does not have physical assets: it has human assets. Financial institutions have typically shied away from such firms for this reason, and because their product development cycles are very long. Thus these firms rely more heavily on equity than working capital. The knowledge-based industry faces unique financing problems. Again, Terry Norman from the Metropolitan Halifax Chamber of Commerce summarised very well the problem : "Much

of the growth in the SME market is being driven by KBIs, and they have non-traditional financing needs, A big portion of the assets of the KBI go home every night in the way of their personal. This requires the shift from assets-based lending to cash-flow lending coupled with a thorough knowledge of the market. In some cases it also requires pricing loans for risk which is contrary to the common practice of the big six chartered banks". The Committee supports recommendations 106 to 108.

The Task Force proposes specific recommendations that should facilitate the provision of credit to aboriginal individuals and institutions, even though some financial institutions have taken important initiatives relating to aboriginal financing. For example, the Bank of Montreal established an aboriginal banking program in 1992. It now operates 16 aboriginal communities banking centres across Canada. It was announced earlier this year that, in co-operation with Canada Post, it would further expand its service in 20 remote communities. The TD Bank has entered in a joint venture with the Saskatchewan Indian Equity Foundation and created the First Nations Bank. Some important and significant steps such as the one described above have had a positive impact on the lives of aboriginal Canadians. The Committee endorses recommendations 109 to 111.

Social Performance

As a first step toward gaining access to personal banking services, one must have access to a bank, access to a bank account. The Task Force concluded that there was a problem in this regard as 600,000 Canadians — or 3% of the population, don't have a bank account.

Mr. Serge Cadieux (Syndicat Banque Laurentienne, Coalition Québécoise pour le maintien des emplois et services bancaires personnalisés)

Groups such as Option Consommateurs in Montreal clearly demonstrated how many of the most vulnerable in our society have no access whatsoever to basic financial services. They have difficulty opening bank accounts or cashing welfare cheques for example. In 1997, 3 percent of adult Canadians did not have a bank account and this number exceeded 5 percent in British Columbia and the Maritimes. Eight percent of adults living in households with annual income under $25,000 did not have basic accounts. This phenomenon can be attributed to identification requirements and to the fact that creditors can seize funds deposited in bank account. Thousands of Canadians rely upon cheque discounters such as Money Mart every week.

Those with a bank account see their deposits, including government cheques, held for 5 to 7 days by deposit-taking institutions. Even though the major chartered banks agreed with

the federal government on a new regime to ease access to account and cheque cashing services for low-income Canadians in 1997, it seems very little progress has been achieved.

The Task Force raises the argument that it is attitudinal and cultural problems that prevent further progress. It is argued that low-income Canadians are not perceived by deposit taking institutions to be profitable customers. Even if profitability was the issue, Canadian financial institutions should not deny Canadians, whatever their socio-economic conditions, the right to have access to basic financial services at a reasonable price. Like all the witnesses heard on this issue, the Committee supports recommendations 88 to 92. However, on the issue of making personal identification available (recommendation 90(a)) the Committee recommends caution, considering the potential abuses and fraud that such a measure could lead to. One just has to look at the Auditor General's recent concerns related to social insurance numbers. Further study is needed before starting to issue ID cards to citizens.

Ninety-four percent of Canadians feel that it is necessary for an individual to have a savings or chequing account. Over half (51 percent) feel this is "absolutely necessary."

We feel that access to basic banking services should be insured and there should be a right for all Canadians. Unfortunately the task force has said the banks should take a number of steps but we're going to give them more time. Citizen groups, anti-poverty groups, consumer groups have been pushing for over ten years with the banks trying to get them to provide service fairly to all Canadians and at a fair price. There should be no further delay. Require banks to give everyone a right to a bank account, require banks to provide access to basic banking services.

Mr. Duff Conacher (Chair, Canadian Community Reinvestment Coalition, and Co-ordinator, Democracy Watch)

Branch closures can have disproportionate impact on the elderly, smaller rural communities, small businesses and low-income individuals. Bricks and mortar that were so important just a few years ago are less crucial today. For example, electronic banking such as ATM, telephone banking and PC banking has revolutionised our relationship with financial institutions. A few years from now we should be able to download money into our smart cards using pay phones or a personal computer. There is no doubt that more and more branches will close as the nature of banking evolves through the use of alternative delivery channels that are less costly than the traditional distribution systems.

If people generally believe that most of the small businesses can do their day-to-day banking electronically, then they are sorely mistaken. . . Retailers also understand the growing possibilities offered by technology. They also know technology is far from being a complete and adequate substitute for services provided by local branches of competing financial institutions.

Ms. Diane Brisebois (President, Retail Council of Canada)

The Committee agrees that financial institutions should be obliged to inform their communities in advance of their intention to close a branch. Hence the Committee supports recommendation 93.

We're heartened therefore by the recommendation of the task force that reinforces the need for financial institutions to be diligent in honouring their commitments in terms of access to basic banking services.

Mr. Andrew Bolter (Director of Community Development Programs, Life Spin — Women's Resource Centre)

For a number of years, the Calmeadow Foundation has pioneered techniques for lending money to individuals who need small amounts to create their own jobs. Micro lending can be viewed as a way of increasing self-employment among various Canadians whose financial needs are too small to interest traditional financial institutions. While the processing costs for such loans might well exceed any possible return to them, such loans

[W]e're working on [micro credit] and hope to have a firm statement and firm commitments with respect to a new approach to microlending in the future and that isn't just a vague promise. We will commit to it and address it in [our] public interest assessment document.

Mr. Matthew Barrett (President and Chief Executive Officer, Bank of Montreal)

[S]uccessful micro-credit programming, in Canada, the United States, and developing countries has proven to be successful but more successful when linked to other forms of service such as small business management training and technical counselling.

Mr. Peter Nares (Executive Director, Self Employment Development Initiatives)

Financial institutions are not likely to give without some encouragement because there's a good risk that some businesses will not survive.

Mr. Roger Snelling (Member of the Board, Montreal Community Loan Association)

have enormous potential in terms of community and individual development. The Committee heard from groups such as the Montreal Community Loan Association. This organisation argued that small lending needs relate to those wanting to borrow from $2,000 to $20,000. "But there is 20% of the population that can't get access to credit from mainline financial institutions. These are people that are living in poverty, but they have good ideas, so how do they get access to credit? Institutions like the Montreal Community Loan Association are the way they get access to that". The Committee believes such initiatives should be encouraged, thus we support recommendations 94 to 97.

Financial institutions are active in the community. For example, the largest five banks were the top five corporate givers in Canada in 1997, donating more than $78 million to philanthropic causes across the country[61]. On top of that, financial institutions with their employees donating their time, play leadership roles in community activities. The Voluntary Sector Roundtable identified a number of new opportunities that could help build stronger and more caring communities that should be further explored by the government and the financial services sector. Hence the Committee suggests that the leaders of the financial institutions and of the voluntary sector explore new partnerships as suggested in recommendation 98. If successful, these new initiatives could significantly improve the condition of our communities.

Community Accountability Statements

Like the MacKay Task Force, the Committee heard from the Canadian Community Reinvestment Coalition that Canada should adopt a law similar to the Community Reinvestment Act (CRA) that applies to banks in the United States.

The demand for community reinvestment began in the United States as part of the civil rights movement in the late 1960's and early 1970's. Many old, urban neighbourhoods were effectively declared off limits by banks and S&Ls. Banks located in some cities would literally draw a red line on a map around lower-income neighbourhoods — they would accept deposits in these

61 See Exhibit 2.43

communities but consciously refused to lend money to businesses or individuals located there, because of the perceived high-risk and low return.

Hence, in 1975, Congress passed the Home Mortgage Disclosure Act (originally known as the Financial Institutions Reporting Act). The industry was required to publish information related to where it was making loans. This Act fuelled the reinvestment movement. In 1977, the communities went further and pressed not just for statistical disclosure but for an affirmative reinvestment mandate. The CRA imposed a legal obligation on lenders to serve all the residents and needs of their community.

The objectives of the CRA include the following: financial institutions must demonstrate that the they are reaching out to all segments of the local credit market and are meeting the credit needs of the entire community, including low- and middle-income neighbourhoods, consistent with safe and sound operations. It does not force financial institutions to lend money to bad credit risks through quotas or mandated credit allocation. Four federal agencies rate each financial institution on compliance with the CRA. Lending institutions are graded every 18 to 24 months using criteria such as geographic distribution of loans and investment and services in the communities they serve. The federal government is required to take into consideration CRA compliance when deciding whether or not to recommend approval or denial of certain applications such as branch closures, acquisitions and mergers or charter applications. The government relies on this reporting system and data disclosure to encourage lending institutions to lend capital in underserved areas. The risk of having an application denied for failure to comply with the CRA is the principle tool of enforcement.

Inspired by the American experience, the Canadian Community Reinvestment Coalition argues that Canadian financial institutions should become more accountable so they can better serve the needs of their local communities. This group recommends the adoption of a Canadian Act.

The Committee does not support this approach. In the first place, in an industry that is continually evolving, the application of a Canadian CRA would be extremely difficult and costly. The new corporate structures of many financial institutions (e.g. financial holding companies) will shift assets out of their traditional banking

subsidiaries, thus reducing the activities covered by a CRA. In tomorrow's financial sector, many banking activities will not be undertaken by traditional banking institutions or traditional product lines. One need only observe the billions of dollars pouring into mutual funds and stocks every year by Canadians. Secondly, the criteria for a satisfactory rating would be subjective and arbitrary — with convergence taking place to varying degrees by financial groups, such a rating system would treat competitors unequally. Thirdly, the primary effect of the regulations is to increase the cost of operations, especially for smaller financial institutions and for institutions operating in low-income neighbourhoods. Fourth, the quest for a good rating might cause financial institutions to adopt accommodating behaviour and chose inappropriate banking practices. These sub-optimal investments could jeopardize the safety and soundness of certain branches. The long-term consequences of these could lead to the closure of branches in already poorly served areas. There is no evidence that Canadian financial institutions are systematically denying credit in poor neighbourhoods. No complaints of any significance have been brought to regulators in Canada.

In addition, the banking sector and the social setting is very different in Canada than in the United States. We have national institutions, they have local ones. Canada does not have the inner city blight that characterizes many American cities. Thus the Committee agrees with the Task Force that there is no need for a CRA-like legislation in Canada.

This does not necessarily mean that financial institutions should not become more accountable. The Task Force also recognizes the fact that Canadian financial institutions must be more accountable to the communities they serve. To achieve this the Task Force recommends (recommendation 99) that federally regulated deposit-taking institutions and life insurance companies be required by law to file Community Accountability Statements. These would describe the financial institution's contributions to the community with respect to relevant aspects such as philanthropy, investment in community development, employment provided, taxes paid to all levels of government, participation of employees in community service. The statements would be filed annually with the Minister of Finance and also tabled with the House of Commons Standing Committee on Finance.

The Committee does not agree with the legislated aspect of this recommendation. First, a legislative requirement would add substantially to the regulatory burden already faced by financial institutions. It would increase costs, especially on smaller financial institutions and new entrants. Edmund Clark from Canada Trust argued strongly against the accountability statement by saying ". . . [R]egulation favours the large [financial institution] against the small, and yet it's often the small that's providing the competition that makes the consumer better off. . ." In its brief, the Canadian Life and Health Insurance Association argued "[T]he industry is nonetheless concerned that such a requirement could become a cumbersome and costly regulatory compliance undertaking at a time when there is already a need to streamline and to reduce the paper burden of the numerous reporting requirements to which the industry is already subject." (see page 43 of the CLHIA submission)

Second, legislated requirements might limit accountability and involvement in community. For example, Mr. Clark added in his presentation that legislating accountability statement would remove the moral responsibility of the CEO to his/her community. He argued that as a CEO he would owe to society nothing more than what he is required to do. He said "Just tell us exactly what we have to do to fulfil this requirement and that's what we will do".

Third, how would a "community" be defined (presence of a branch in a neighbourhood, postal code, geographical distribution of clients. . .)? Would a branch located in an industrial park have to table a community accountability statement? How would a virtual bank such as ING Bank, Citizen's Bank or Mbanx define their local community?

Fourth, as was said before, banking functions, as we knew them yesterday, are already very different today and will continue to change. Should monoline institutions operating from abroad such as Wells Fargo, or Countrywide Credit be obliged to file an accountability statement? Why only force the traditional banking sector to obey such community requirements? As stated by Jean Roy from the Hautes Études Commerciales "However, it must be clearly understood that there is potential for putting large Canadian institutions in a difficult situation since on the one hand they would be asked to play a social role and on the other hand the new

financial environment carries the risk of putting them into competition with various types of financing institutions that do not have to fulfil such social roles."

And finally, Canadian banks also need to respond to the increasing expectations of Canadians that financial service firms should provide tangible support for communities and pursue more community customer partnerships.

Mr. John Cleghorn (Chairman and Chief Executive Officer, Royal Bank of Canada)

Finally, it is unclear what the House of Commons Finance Committee is supposed to do with the tabled statements. With thousands of accountability statements to look at, it is unlikely that the parliamentary public review process suggested by the Task Force would be effective.

The Committee is opposed to recommendations 99 and 100. It believes instead, that voluntary action should proceed, instead of another layer of regulation. The Committee believes that it is in the best interests of the financial services sector to be involved in the community, and to do so in a way that meets the needs of that community. In such a case, the institutions would obviously wish to disclose their activities. It is good business practice for institutions to do so and they do not need a Parliamentary Committee to suggest good business practices to them.

LIST OF RECOMMENDATIONS

Enhancing Competition and Competitiveness

General

1. Because the financial services marketplace in Canada, as in the rest of the world, is in a state of rapid change, governments and institutions should respond promptly to this report. In the case of the federal government, the implementation of these recommendations should not await the regular review of federal financial institutions legislation scheduled for 2002.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Rapid changes are taking place in the industry. The federal government has an opportunity to ensure that the proper policy, regulatory and legislative frameworks are put in place quickly to allow Canadian financial institutions to take advantage of new business opportunities and to allow Canadian consumers to benefit from enhanced competition and increased choice.*

2. Sound corporate governance practices in individual institutions lie at the heart of ensuring a Canadian financial services sector that is both competitive and prudentially safe and sound. In light of this:

(a) The Task Force urges OSFI and other Canadian regulators to emphasize the constant improvement of corporate governance in their regulatory work.

(b) The Task Force encourages further active public discussion of ways to improve the governance of publicly traded Canadian financial institutions, including the requirement that there be a non-executive board Chair with adequate resources and time to fulfil the important responsibilities of such a position.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*An ever changing industry requires a regulatory structure that keeps pace with the challenges that innovation brings. All financial regulators must be able to respond to the new players, new products and new ways of doing business that will characterize the sector in the future.*

3. Canadian public policy should continue to support the Canadian control of large regulated financial institutions carrying on business in Canada. Specifically:

(a) There should be a redefined widely-held rule applicable to all large federally regulated financial institutions, designed to foster continuing Canadian control of a significant part of the financial services sector.

(b) The other existing legislative requirements designed to achieve Canadian control should be maintained.

(c) The legislation should be strengthened by a provision to make it clear that the principal executive functions of widely held, federally regulated financial institutions are required to be carried out in Canada.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee believes that Canadian control of Canadian financial institutions should be maintained. Significant and important policy objectives related to tax revenues, sensitivity to domestic needs, international presence, and a strong and dynamic domestic financial services industry can be attained by domestic control. (See recommendations 29, 30 and 33)*

Enhancing Competition: Facilitating New Entrants to the Market

4. The criteria and processes for the incorporation and regulation of financial institutions should be revised to facilitate the establishment and growth of new financial institutions. Specifically:

(a) The Minister of Finance should have discretion to allow a new financial institution, including a bank, to incorporate with less than the $10 million in capital currently required, subject to approval by OSFI of the institution's business plan.

(b) OSFI should streamline its processes to ensure that applications for approval of the establishment of new financial institutions are processed as efficiently as possible and within a period of time not to exceed 120 days as the norm.

(c) Ongoing regulatory requirements should be revised from a "one size fits all" policy. The administrative burden of regulation for smaller or niche institutions should be commensurate with their size and the nature of their business activities, and not determined by requirements designed for large multi-product financial conglomerates.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee believes that a capital threshold below $10 million will foster the establishment of new, smaller and specialized financial institutions, while still maintaining safety and soundness goals.* *Furthermore, as small, regulated institutions bear a disproportionately high compliance cost, the Committee endorses the new regulatory principle proposed in 4(c).*

5. There should be a 10-year holiday for new financial institutions from federal capital tax (including both large corporation and Part VI tax). The Task Force urges provincial governments to introduce similar holidays to encourage new entrants in their jurisdictions, free from the debilitating impact of capital taxes on start-ups.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*A tax holiday for new institutions could create an unlevel playing field. The Committee instead supports the reduction of special capital taxes on financial institutions, at both the federal and provincial levels, as fiscal conditions permit. (See recommendation 44). Other measures proposed in this Report will help to facilitate new entry.*

6. Ownership rules should be revised as described under the heading "Ownership Rules and Enhanced Competition" to permit the establishment of new closely held banks and cooperative banks.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*See recommendation 22.*

7. There should be a clearer regulatory framework within which providers of financial services from outside Canada can do business with Canadians. See recommendation 119.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*See recommendations 119 to 124.*

8. Withholding taxes should be removed for interest on all arm's-length borrowings, regardless of their term, to encourage non-resident lenders to compete in extending credit to borrowers in Canada.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The impact of the present tax treatment of arm's length borrowings increases the borrowing costs of Canadians or denies them access to foreign sources of credit. This recommendation would make consistent the treatment of both short and long-term borrowings.*

9. Canadian public policy should encourage foreign financial institutions to carry on business in Canada in order to broaden the choice of providers of financial services to Canadians. To that end:

(a) Foreign banks should be able to carry on any banking business in Canada, other than the taking of retail deposits (i.e., deposits below $150,000), through branches of the foreign banks as well as through subsidiary corporations, as is now the case.

(b) The Task Force endorses the conditions for branch entry outlined in the Department of Finance consultation paper published in September 1997, except that:

(i) the proposed condition that the foreign bank must have $25 billion in assets world-wide should be revised to permit smaller, well-capitalized foreign banks to compete in the Canadian marketplace through branch operations; and

(ii) the requirement that the foreign bank should have international experience should be restated to encourage entry from competent banks that may not have international experience, but may still be able to contribute to enhancing competition in Canadian markets.

(c) Foreign banks that wish to take retail deposits in Canada should continue to do so through subsidiaries and branches of those subsidiaries, to ensure adequate depositor protection.

(d) The regulatory regime applicable to foreign bank subsidiaries and branches should be as light as possible. Prudential regulation should be substantially reduced where the foreign bank does not take retail deposits.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee agrees with the new proposed foreign entry regime. Legislation that will allow direct wholesale banking should be tabled and enacted as soon as possible. This recommendation constitutes part of Canada's commitment to the WTO.* *Like the Task Force, the Committee does not support retail banking by anything other than foreign bank subsidiaries.*

10. OSFI's statutory mandate should be revised to make it clear that OSFI should balance competition and innovation considerations with its present responsibilities in respect of safety and soundness. See recommendation 112.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*See recommendation 112.*

11. To facilitate the early adoption in Canada of electronic commerce in financial services and the added competition it will bring, governments at all levels should make it a priority to ensure that all legislation is compatible with an electronic commerce market environment.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*See recommendations 122 to 124.*

Enhancing Competition: Equity in Consumer Insurance Plans

12. In order to promote more effective competition between banks and life insurance companies, there should be the same level of support from the federal government for the insurance plans protecting customers of deposit-taking institutions and customers of life insurance companies. See recommendation 117.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*See recommendation 117.*

Enhancing Competition: Expanded Business Powers

Payments Systems Issues

13. The Canadian Payments Association Act should be amended to permit financial institutions other than deposit-takers to become members of the Canadian payments system upon designation by the Minister of Finance as meeting criteria related to their solvency, liquidity, and regulatory and legal frameworks. The Department of Finance, working with the Canadian Payments Association, should give high priority to determining the classes of institutions which should be eligible. The Task Force expects life insurance companies, securities dealers and money market mutual funds to qualify with few, if any, restrictions.

14. The Minister of Finance, rather than the Governor-in-Council, should have the power to approve new by-laws of the Canadian Payments Association or changes in existing by-laws. In addition, the Minister of Finance should have the power to review all new or revised rules of the Association, and to revoke any new rule or revision to existing rules which the Minister determines to be contrary to the public interest.

15. The Minister of Finance should also have the power to issue a directive to the Canadian Payments Association to require a change in a by-law, rule or operating practice which the Minister determines to be in the public interest.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree to recommendations 13 to 15	*This set of recommendations will ensure greater access to the CPA and help prevent barriers to entry from being erected. Empowering the Minister of Finance to issue directives will be beneficial to the financial services sector and to consumers. It is important that new entry be achieved in such as way that the integrity and efficiency of the system not be compromised.*

Access to Other Networks

16. The Minister of Finance should monitor the operations of all networks in Canada to ensure that they are operated in a manner designed to enhance competition in financial services and competitive equity among financial services providers. If significant anti-competitive practices are found, legislation should be considered to ensure network access to all competitors on reasonable terms and conditions, and with fair compensation to network sponsors.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This should help competition to flourish. Access to large-scale networks such as Interac could be especially beneficial to smaller institutions and new entrants.*

17. The members of Interac should take the necessary steps so that the Interac network is fully functional to permit the network to be used for as many functions as the technology permits, including the making of deposits through any ATM to any participating deposit-taking institution.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree in principle	*The Committee agrees with this initiative in principle. Technical problems and security issues must be resolved before inter-institutional deposits through ATMs are permitted. Moreover, the increasing fonctionality of networks expected by the Task Force may well reduce the efficiency of the electronic payment system if it means greater use of paper transactions, while the system itself is increasing automated.*

Retailing Insurance by Deposit-Taking Institutions

18. Subject to the adoption of appropriate privacy and tied selling regimes, federally regulated deposit-taking institutions should be permitted to retail insurance through their branches and to use their customer information files to assist in retailing insurance.

(a) Deposit-taking institutions with less than $5 billion in shareholders' equity should be permitted to retail insurance through their branches and to use their customer information files to assist in retailing insurance, as soon as legislation in respect of privacy and tied selling is in place.

(b) All other companies should have access to the new powers on January 1, 2002.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*The Committee believes that the state of competition in the Canadian financial services sector will be enhanced by the recommendations of the Task Force Report. We also believe the current system of consumer protection to be inadequate. We* ***recommend*** *therefore that the government give high priority to the establishment of a new consumer protection regime, and act quickly to do so. Such a regime would include:* • *An improvement in the transparency of contracts and the full and timely disclosure of contract terms (Task Force recommendations 57 to 62);* • *Enhanced, legislated privacy safeguards that that would allow the consumer to control the use of personal information, by requiring explicit customer consent which may subsequently be withdrawn (Task Force recommendations 64 to 69);* • *A legislated and expanded ban on coercive tied selling, along with a redress mechanism and a requirement that financial institutions inform customers as to what practices constitute coercive tied selling, prior to a transaction being completed (Task Force recommendations 70 to 75);* • *A redress mechanism that includes an independent financial services sector ombudsman (Task Force recommendations 76 to 80);* • *The establishment of a Consumer Protection Bureau.*

	The Committee ***recommends*** *that the House of Commons Standing Committee on Finance be instructed to evaluate the new consumer protection and competition regime in order to determine whether or not it is effective and raises the standard of protection for consumers. This evaluation is to be conducted prior to the next scheduled review of federal financial institutions legislation, and receive input from stakeholders.* *Therefore, the existing prohibition against federally regulated deposit-taking institutions retailing insurance in their branches will only be reconsidered in light of the results of the above-mentioned evaluation.*

19. Employees of deposit-taking institutions who are engaged in the sale of insurance should comply with applicable provincial requirements with respect to the education and licensing of insurance salespersons, so long as such requirements are non-discriminatory.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Those selling insurance products must be licensed and meet all of the qualifications that are required of others selling similar products.*

20. The insurance and deposit-taking sectors should work with the provinces to develop a model code for licensing and consumer protection issues arising from the sale of insurance at branches of deposit-taking institutions.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	

Light Vehicle Leasing

21. Subject to the adoption of appropriate privacy and tied selling regimes, federally regulated deposit-taking institutions and life insurance companies should be permitted to lease light vehicles, including automobiles, to consumers.

(a) Deposit-taking institutions and life insurance companies with less than $5 billion in shareholders' equity should be permitted to lease light vehicles as soon as legislation in respect of privacy and tied selling is in place.

(b) All other companies should have access to the new power on January 1, 2002.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*The Committee believes that the state of competition in the Canadian financial services sector will be enhanced by the recommendations of the Task Force Report. We also believe the current system of consumer protection to be inadequate. We* ***recommend*** *therefore that the government give high priority to the establishment of a new consumer protection regime, and act quickly to do so. Such a regime would include:* • *An improvement in the transparency of contracts and the full and timely disclosure of contract terms (Task Force recommendations 57 to 62);* • *Enhanced, legislated privacy safeguards that that would allow the consumer to control the use of personal information, by requiring explicit customer consent which may subsequently be withdrawn (Task Force recommendations 64 to 69);* • *A legislated and expanded ban on coercive tied selling, along with a redress mechanism and a requirement that financial institutions inform customers as to what practices constitute coercive tied selling, prior to a transaction being completed (Task Force recommendations 70 to 75);* • *A redress mechanism that includes an independent financial services sector ombudsman (Task Force recommendations 76 to 80);* • *The establishment of a Consumer Protection Bureau.*

	*The Committee **recommends** that the House of Commons Standing Committee on Finance be instructed to evaluate the new consumer protection and competition regime in order to determine whether or not it is effective and raises the standard of protection for consumers. This evaluation is to be conducted prior to the next scheduled review of federal financial institutions legislation, and receive input from stakeholders.* *Therefore, the existing prohibition against federally regulated financial institutions leasing automobiles will only be reconsidered in light of the results of the above-mentioned evaluation.*

Enhancing Competition: The Co-operative Sector

22. Federal legislation should permit co-operative banks and other financial institutions to be chartered as new institutions, with ownership and governance to be based on co-operative principles. Subject to compliance with applicable provincial legislation, provincial credit unions and credit union centrals should be able to continue as co-operative banks under the Bank Act.

23. Federal and provincial governments should take such steps as may be available, within their respective jurisdictions and subject only to prudential constraints, to remove legislative and other regulatory barriers to the success and growth of the co-operative financial services sector, including in particular credit unions and caisses populaires.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree to recommendations 22 and 23	*The co-operative sector faces unique challenges in serving members. Institutions are often small, and therefore can offer only a limited range of services. Provincial legislation restricts them from providing inter-provincial services. The Committee agrees that the creation of co-operative banks could solve many of these problems.*

24. Restrictive provisions contained in the Co-operative Credit Associations Act upon the business activities of credit union centrals should be removed except to the extent that they are necessary for prudential reasons. Specifically:

(a) A credit union central should have the ability to provide wholesale financial services to another financial institution without the present requirement that the

other institution first make an investment in a subsidiary service corporation of the credit union central.

(b) Credit union centrals should have the ability to provide retail financial services directly to members of local credit unions.

(c) Where credit union centrals act in concert in relation to an investment, they should be treated as one entity for purposes of the Minority Investment Regulations.

(d) The credit union movement, OSFI and the Department of Finance should establish a Working Group to resolve any prudential issues.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Some members of co-operative financial institutions wish to retain the current credit union system, while enabling it to be more efficient. These recommendations would allow the credit union system to achieve economies of scale and scope that are presently denied to it. There is no policy rationale for prohibiting credit union centrals from offering services to individual members of credit unions, not just the credit unions as is now the case.*

Enhancing Competition: More Flexible Corporate Structures

25. There should be no restrictions on corporate structures available to financial institutions unless required by safety and soundness considerations.

26. Federally regulated financial institutions should have the option of being organized as subsidiaries of regulated financial holding companies incorporated under a new Financial Holding Companies Act. Specific principles to be applicable in the holding company regime would include the following:

(a) The regulatory requirements applied to the holding company and its unregulated subsidiaries should be as non-intrusive as possible.

(b) The ownership requirements, and the other prescribed indicia of Canadian control which are applicable to regulated financial institutions, would also be applicable to financial holding companies.

(c) The holding company would be required to have a controlling interest in its principal Canadian operating regulated financial institutions.

(d) The holding company should be capitalized in such a way as to avoid double gearing and so that the holding company can serve as a source of strength for the group.

(e) The holding company would be a non-operating company and its permitted investments and downstream subsidiaries should mirror those of operating regulated financial institutions conducting business under the financial institution parent model.

(f) Related-party rules would apply to transactions between the holding company and its subsidiaries.

(g) OSFI should have full access to information from all companies in the corporate group.

(h) There should be disclosure rules to ensure that persons dealing with unregulated entities in the corporate group are clearly informed that the entities are not regulated, that their securities are not deposits and are not insured or guaranteed by CDIC or any other government-sponsored insurance program, and that related regulated financial institutions do not provide guarantee support. Unregulated entities within the group should not be able to use the name “bank”.

(i) A reorganization of a regulated financial institution as a subsidiary of a holding company under the Financial Holding Companies Act would require the approval of OSFI.

COMMITTEE’S RESPONSE:	COMMENTARY
Agree	*The Committee agrees that the use of a financial holding company model would be beneficial to financial institutions wishing to form alliances with others and consequently become more competitive. This model could also remove some of the regulatory inequities that now exist between regulated financial institutions and unregulated ones. The Committee* ***recommends*** *that the regulated financial holding company be subject to as little regulation as possible.*

27. Existing unregulated holding companies should be grandfathered so that they would not be required to comply with the provisions of the Financial Holding Companies Act, subject to OSFI’s continuing to be satisfied with the quality and substance of undertakings in respect of prudential issues. The grandfathered status would be lost if the grandfathered company controlled both a bank in Canada and a foreign bank.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Existing unregulated holding companies that continue to satisfy OSFI should not have to be subject to regulation. The Committee* ***recommends****, however, that if control of an unregulated holding company changes hands twice, it should become a regulated holding company. This is consistent with recommendation 41.*

28. The Department of Finance and OSFI should review the present downstream restrictions on subsidiaries and minority investments with the objective of determining:

(a) whether activities that are currently required to be conducted in the parent financial institution could be permitted to be conducted either in a permitted subsidiary or in minority investment form; and

(b) whether functions which are now required to be carried on in a subsidiary could be permitted to be carried on by way of minority investment.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This recommendation is consistent with others that promote more efficient regulation.*

Enhancing Competition and Competitiveness: Ownership Rules

29. The ownership rules should be designed to foster:

(a) entrepreneurship and competition;

(b) the safety and soundness of the system; and

(c) the preservation of Canadian control of substantial parts of the financial services sector.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee agrees with the three objectives specified in the recommendation. By basing ownership parameters on size, the Task Force succeeds in offering an ownership regime that promotes new entry while at the same time protecting Canadian control of large financial institutions. This new regime would allow commercial ownership links for smaller institutions but not the largest ones.*

30. In respect of large financial institutions, the maintenance of Canadian control and the better assurance of safety and soundness by the separation of commercial and financial interests are key principles underlying the ownership rules. For those reasons, large financial institutions should be widely held, as defined in recommendation 33. It is important to foster entrepreneurship and competition in the start-up and growth of new financial institutions; accordingly, smaller financial institutions should not be required to be widely held.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This recommendation has its greatest impact on the creation of new domestic banks. The existing Bank Act prohibits an entrepreneur from holding more than 10% of the shares of a domestic bank ten years after its incorporation.*

31. Any holding of more than 10 % of any class of shares in a federally regulated financial institution by a person or group of persons acting jointly or in concert should continue to require the prior approval of the Minister of Finance, on a "fit and proper person" test.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	

32. There should be a single ownership regime, consistent across the financial services sector, which is based on the size of the institution measured by its shareholders' equity. The essential parameters of the ownership regime would be as follows:

(a) In order to foster start-ups and competition, institutions with less than $1 billion in shareholders' equity would be able to be closely held, including sole ownership by one person or company.

(b) In order to provide enhanced corporate governance in the interest of safety and soundness for growing institutions, financial institutions with more than $1 billion but less than $5 billion in shareholders' equity would be required to have at least 35 % of their voting participating shares widely held and publicly traded.

(c) The Minister of Finance would have the authority to exempt a subsidiary of a foreign financial institution from the requirement to have a 35 % public float.

(d) The largest financial institutions, those with shareholders' equity in excess of $5 billion, would be required to be widely held as described in recommendation 33.

(e) A widely held, regulated financial institution that is incorporated in Canada should be able to hold up to 100 % of the shares of another regulated financial institution, regardless of size.

(f) Where a single owner or group of related owners has effective control of more than one regulated financial institution, the applicable ownership rule will be determined on the basis of the combined shareholders' equity of the controlled financial institutions.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee strongly supports the proposed single ownership regime for all institutions. Convergence in the financial sector is leading institutions to increasingly become stronger competitors to one another. Opening up the payments system to new entrants also enhances this convergence. A single ownership regime is, therefore, appropriate.* *Recommendation 32 (a) and (b) should foster the establishment of new financial institutions controlled by a single shareholder, if shareholders' equity does not exceed $1 billion and a dominant shareholder until equity reaches $5 billion. This regime offers greater scope for entrepreneurs to create and/or grow their financial institutions into significant players before having to give up ownership control.* *Recommendation 32 (d) will help ensure that Canada's largest financial institutions will remain under Canadian control (see recommendations 3 and 33). This recommendation also supports the regulatory oversight of large financial institutions by prohibiting the control of those institutions by commercial enterprises.* *Recommendation 32 (e) has the effect of making Canadian banks subject to acquisition by other widely-held domestic financial institutions.*

33. Large financial institutions, i.e., those with shareholders' equity in excess of $5 billion, would be subject to the following widely-held requirements:

(a) As described in recommendation 31, no person, or group of persons acting jointly or in concert, would be allowed to own or control more than 10 % of any class of shares without the approval of the Minister of Finance.

(b) The Minister of Finance should have discretion to permit ownership positions in any class of shares in excess of 10 % and up to 20 %. Shareholders permitted by Ministerial order to own more than 10 % should not collectively own or control more than 45 % of any class of shares.

(c) The Minister of Finance should also have the discretion to permit a shareholding, on a temporary basis, in excess of the 20 % limit, subject to the Minister's approving a plan from the shareholder to divest to an agreed percentage (not to exceed 20 %) within a fixed time period. The Minister should be empowered to obtain and enforce undertakings from any person holding such an excess shareholding, both to confirm the agreement in respect of the divestiture of the shares and to assure that voting rights will not be exercised on the shares in excess of 20 % during the period prior to disposition.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Recommendation 33(b) is designed to enhance the value of equity as a currency in facilitating consolidations. It has the effect of limiting the number of times a financial institution may use the provision, however. If each of two shareholders already hold 20% of equity, no further exemptions could be granted, even if in the public interest.*

	*The Committee **recommends** that the government communicate clearly the rationale behind any limits to the use of 33(b). If it is designed to limit the concentration of ownership, that should be made clear and appropriate limits set. If it is designed to limit the frequency of the provision's use, the government should clarify why a transaction that is otherwise in the public interest as defined in recommendation 34 should not be allowed to make use of this provision.* *The Committee **recommends** that the government should establish parameters that would clarify the limits under which the discretionary power of recommendation 33(c) would be exercised.*

34. Although the discretion of the Minister of Finance to permit a shareholding in excess of 10 % for institutions that must be widely held should not be constrained by statute:

(a) The discretion should be exercised when the Minister concludes that the excess shareholdings would:

(i) enhance competition or competitiveness in the financial services sector;

(ii) enhance the safety and soundness of the Canadian financial services system; or

(iii) foster the growth of the Canadian financial services industry by, for example, facilitating a business alliance or an acquisition by a Canadian financial institution.

(b) The increased shareholding limit should not be generally available for passive investments in which the excess shareholding would add no value to the business beyond the investment of the shareholder.

(c) The Minister should issue guidelines to identify the circumstances in which the Minister would be prepared to consider an application to exercise the discretion.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*See recommendation 33.*

35. An institution which reaches the $1 billion and $5 billion thresholds, and which therefore becomes subject to new ownership criteria, should have a reasonable period of time, to be determined with the approval of the Minister, to comply with the applicable requirements of the ownership regime.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*An institution that crosses the threshold through internal growth should be expected to anticipate the consequences of doing so, and make preparations in advance. An institution that crosses the threshold via acquisition would have less opportunity to make preparations to divest shares. The Committee* ***recommends*** *that guidelines should be published by the Minister that would clarify the time available to comply with the ownership rules.*

36. Businesses organized in the cooperative or mutual form of ownership should be deemed to comply with the widely-held rules by definition and without the need for special exemption, whatever their size.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This is consistent with the way mutual insurance companies are now treated in the Bank Act.*

37. In respect of financial institution holding companies, the ownership rules should apply to the holding company on the basis of the combined shareholders' equity of the regulated financial institutions controlled by the holding company.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This recommendation is consistent with 32 (f) and is a logical extension of the ownership regime proposed by the Task Force. This recommendation prevents Financial Holding Companies from being used to circumvent the proposed, size-based ownership regime*

38. In respect of demutualized life insurance companies, they should become subject to the general, size-based ownership regime after a transition period of three years from the date of demutualization. Demutualized companies with shareholders' equity in

excess of $5 billion would have to be widely held and remain so from the date of demutualization. Transition guidelines for the three-year period should assure that all demutualized companies, as a matter of principle, are not subjected to hostile takeover bids or amalgamation proposals. The guidelines should therefore provide that the smaller demutualizing companies should also be widely held for the three-year transition period. The transition guidelines should also provide that, in the normal course, the Minister of Finance should not approve any proposal for merger or acquisition of any newly demutualized company. However, should any demutualized company and its board of directors propose a transaction that, in the opinion of the Minister, is clearly in the public interest and desirable to conclude within the three-year transition period, it should be allowed to proceed.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	The Committee **recommends** that an adequate transition period be available to insurance companies, converting from mutual status to stock companies, so as to protect them from hostile take-overs. The Committee sees the transition period as one which protects the newly-converted institution against certain circumstances (such as a hostile take-over bid), not as one which subjects the institutions to severe consolidation constraints, limiting their ability to undertake legitimate business strategies. The newly converted companies should be free to undertake mutually acceptable business consolidation if they see it as desirable. Hence the Committee **recommends** that the Minister of Finance should be permitted to consider applications for amalgamations or acquisition from the Board of Directors of converted institutions during the transition period.

39. The Government should have the power, to be used only in exceptional cases, to approve the acquisition of a large widely held Canadian financial institution by a foreign purchaser, free from the impact of the widely-held rules. Any such transaction should be subject to:

(a) the completion of the usual processes for merger approval (i.e., review by the Competition Bureau and OSFI, and Ministerial approval following the completion of the Public Interest Review Process); and

(b) the following additional criteria being met:

(i) the buyer should be a widely held, regulated financial institution approved by OSFI;

(ii) the acquisition should be approved by the Governor-in-Council on the recommendation of the Minister of Finance that the acquisition would be in the Canadian public interest by enhancing competition or competitiveness in the financial services sector or by enhancing the safety and soundness of the Canadian financial services system; and

(iii) enforceable undertakings should be provided by the buyer to the Minister to ensure that the transaction provides its intended benefits to Canada.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The government should clearly specify the circumstances in which such power is to be used.*

40. A Schedule I bank which is subject to the present 10 % rule but which would not, by reason of its size, be subject to the new size-based, widely-held regime would initially be subject to the new widely-held rule but would have the right to be recategorized into the class of financial institution, with the resulting ownership rules, which would apply by reason of its shareholders' equity. This recategorization would require the approval of the board of directors of the bank, confirmed by a special resolution of the shareholders and the approval of the Minister of Finance.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This is consistent with the Committee's views on the size-based ownership regime. It could facilitate alliances between some of the smaller Schedule I banks and insurance companies, for example.*

41. A company with share ownership not conforming to the new ownership rules at the time of their introduction should be permitted to continue business without altering its ownership structure, subject to the Minister being satisfied with the quality and substance of the undertakings provided by any controlling shareholder in respect of prudential issues. Such a company should not be permitted by reason of its grandfathered status to acquire an institution that, by virtue of its size, must be widely held. There would be no requirement for the dilution of the share ownership of the control block, whatever the shareholders' equity of the financial institution might be at any time. A regime should be adopted so that, over time, the nonconforming institution would come into compliance

with the ownership regime. Particulars of options which the Task Force suggests should be available to the controlling shareholder are set out in Background Paper #2.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This ensures that existing institutions are not penalized by the establishment of a new ownership regime. Only two institutions, Great-West Life Insurance Company and CT Financial (Canada Trust) would be affected.*

Enhancing Competitiveness: Accounting Principles

42. Canadian accounting principles relating to the creation and amortization of goodwill in business combinations should be revised to eliminate their present negative impacts on financial sector restructuring in Canada and on the ability of Canadian financial institutions to successfully compete for acquisitions outside Canada. To that end:

(a) The Task Force urges the Canadian Institute of Chartered Accountants, working with OSFI and the financial institutions, to develop a mutually acceptable interim solution, to be applicable until such time as Canadian and U.S. accounting principles in respect of business combinations are harmonized.

(b) If the Canadian Institute of Chartered Accountants is not able to determine a solution, OSFI should use its power to specify principles for business combinations and goodwill accounting so as to (i) facilitate consolidations of small and mid-sized Canadian financial services companies into stronger competitors in the Canadian marketplace, and (ii) permit Canadian companies to participate on a competitive basis in pursuing acquisition opportunities.

43. The Canadian Institute of Chartered Accountants, in its ongoing work, should be sensitive to changes, and the timing of changes, in Canadian accounting principles and practices that might negatively affect the international competitiveness of Canadian financial institutions or impede the start-up and growth of new Canadian financial institutions.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommandations 42 and 43	*OSFI and the CICA should rapidly issue new accounting guidelines that will eliminate the adverse impact the present rules have on the ability of Canadian financial institutions to restructure, and to undertake foreign acquisitions. The Canadian Institute of Chartered Accountants has recently announced that new rules should be in place by the fall of 1999. The Committee supports these recommendations and recent initiatives of CICA. We* ***recommend*** *that any interim solution also address the existing bias in favour of mergers of equals.*

Enhancing Competitiveness: Taxation

44. Governments in Canada should recognize the importance of financial institutions to the Canadian economy, both as strong domestic industries with significant international potential and as vital contributors to the health of other Canadian enterprises. Because the level of taxation of Canadian financial institutions is damaging to the competitive position of Canadian companies and is increasing costs to Canadian users of financial services:

(a) As fiscal conditions permit, governments should take steps to reduce the level of taxation so that the financial services industry is equitably treated vis-à-vis other sectors in the Canadian economy, and competitively taxed vis-à-vis financial institutions in other countries.

(b) In particular, steps should be taken both at the federal and provincial level as soon as possible to address the burden which special capital taxes place on financial institutions:

(i) Special capital taxes on financial institutions should be eliminated. If this is not possible, the recommendations in (ii), (iii) and (iv) should be pursued.

(ii) To the greatest extent possible, the tax burden should be shifted from capital and toward profits.

(iii) The federal government should work with the provinces to define a common tax base related to capital.

(iv) Efforts should be made to define a capital tax base that would tax capital in excess of that required for regulatory purposes very lightly or not at all, so as to encourage Canadian financial institutions to be well capitalized.

(c) The Task Force urges provincial governments to be sensitive to the double taxation consequences of transaction taxes on insurance premiums (such as the GST, sales taxes and premium taxes) and their impacts on consumers and, over time, to take measures to alleviate those impacts.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree in principle	*The Committee supports the principle of relying more on profit-sensitive taxes and less on capital taxes, especially when capital is needed to ensure safety and soundness. This set of recommendations should be acted upon as soon as possible and as soon as the budgetary position of the federal and provincial governments allow. Recommendations 44(b) (ii) and (iii) do not have adverse revenue implications for governments.* *Capital taxes discourage entry into the financial sector and as a result, the Committee believes the move to profit-sensitive taxation would add to other Task Force recommendations designed to promote more entry and enhance competition.*

Preserving Competition: Consolidation and Mergers

45. There should be no general policy which prevents large institutions from entering into business combinations with other large institutions, whether by amalgamation, acquisition or in other ways. The "big shall not buy big" policy should not apply to any federally regulated financial institution, including the Schedule I banks.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Consolidation is a legitimate business strategy. Proposals for mergers and acquisitions should be assessed on their individual merits. They should be approved only if in the public interest. Consolidation proposals must satisfy the Competition Bureau that no adverse effects on competition will result. They must satisfy the Superintendent of Financial Institutions that they pose no material safety and soundness concerns. They must satisfy the Minister of Finance that they are in the public interest.*

46. Business combinations involving a federally regulated financial institution should be assessed by (a) the Competition Bureau under the Competition Act in respect of competition concerns, (b) the Office of the Superintendent of Financial Institutions in respect of prudential issues, and (c) the Minister of Finance in respect of general public interest considerations. Relevant information should be shared on a confidential basis among these parties as part of the review process.

47. In respect of the review by the Competition Bureau:

(a) The Task Force endorses the general approach proposed by the Director of Investigations and Research in his submission to the Task Force in November 1997, as amended by the Merger Enforcement Guidelines for Financial Institutions issued on July 15, 1998.

(b) The Task Force agrees, in particular, that the Director should not assess mergers on a "first in, first out basis," but rather should consider all merger proposals separately and in combination, as the Bureau makes its determination.

(c) The Director should pay particular attention to the competition concerns of small and medium-sized business, users of personal financial services who may still be branch-dependent, and regional markets where there are few alternative suppliers.

(d) The Director should consider the new competitive choices which already exist in respect of certain product lines and which are also likely to emerge as a result of the emergence of new channels of distribution and liberalization of public policy constraints.

(e) Where necessary, the Director should actively pursue remedial options.

(f) In reviewing merger proposals and in carrying out other responsibilities under the Competition Act, the Director should consider the extent to which the terms and conditions of access to networks, and their functionality, inhibit effective competition.

48. In respect of the review by OSFI:

(a) The Superintendent's attention should be directed at identifying a new prudential risks that may arise by reason of the transaction.

(b) OSFI should be prepared to provide assistance, including the secondment of personnel, to the Competition Bureau to ensure that it has sufficient expertise, with industry experience and awareness, to assess and protect the public interest from the competition perspective.

49. In respect of the review by the Minister of Finance:

(a) The approval of the Minister should be required for all business combinations involving one or more federally regulated financial institutions, except for a transaction between two federally regulated institutions which does not require pre-notification under the Competition Act. This should be subject to approval by the Superintendent.

(b) If two or more institutions, at least one of which is federally regulated, propose to combine to form an enterprise with shareholders' equity of more than $5 billion and where each of the combining institutions has at least $1 billion of shareholders' equity, the Minister should require a formal Public Interest Review Process prior to determining whether to grant approval. The Minister should have the right to invoke the Public Interest Review Process in the case of other transactions.

(c) The Minister should issue Public Interest Review Process guidelines to describe the mechanics of the process. The guidelines should require merger proponents to submit a detailed Public Interest Impact Assessment (i) describing their business plan and objectives; (ii) clearly identifying the benefits and costs to the nation and the public of the proposed transaction, including the considerations described in (d) below and such other considerations as the Minister may specify; and (iii) outlining any remedial or mitigating steps in respect of public interest costs, and any assurances in respect of public interest benefits, which are proposed by the merger proponents.

The Public Interest Impact Assessment should be available for public comment for a reasonable time period to be specified by the Minister. The decision of the Minister on the proposed transaction should be made as promptly as possible following the public comment period.

(d) In assessing whether approval should be given, the Minister should review the recommendations of the Director and the Superintendent, and the views obtained in the Public Interest Review Process, in light of all relevant public interest considerations, including:

(i) the costs and benefits to individual customers and small and medium-sized business;

(ii) regional impacts;

(iii) international competitiveness;

(iv) employment;

(v) the adoption of innovative technologies; and

(vi) the extent to which approval may create a precedent.

50. Merger proponents should endeavour to structure their proposals in a manner that is consistent with public interest goals. It should be the objective of all parties to balance (a) institutional interests, e.g. the achievement of substantial efficiencies and enhanced competitiveness from the merger, with (b) public interest objectives, e.g. continued competitive markets, the mitigation of public interest costs and the maximization of public interest benefits. The Minister should be prepared to work with merger proponents to help them structure transactions with important public interest considerations in a manner which will better assure the public good.

51. Mergers of large financial institutions should be permitted as long as, after implementing any necessary remedial or mitigating steps, the Minister is of the opinion that markets will remain competitive, that there are no material safety and soundness concerns, and that the transaction is in the public interest.

52. The Minister should have legislative authority to seek and obtain enforceable undertakings from merger proponents to ensure that commitments made to address competition and other public interest concerns are fulfilled:

(a) The Department of Finance should monitor compliance with such undertakings and report regularly to the Minister, who in turn should report to Parliament.

(b) The Governor-in-Council, on the recommendation of the Minister of Finance, should have the authority to issue directions in respect of undertakings, including a direction to cease from committing an act, or to perform such act, as in the opinion of the Minister is necessary to remedy a situation where an undertaking is not being met.

(c) Strong sanctions should be provided for non-compliance with undertakings given by merger proponents and directions of the Governor-in-Council.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 46 to 52	*The Committee believes that mergers and acquisitions are a legitimate business strategy in the financial services sector. The goal of the government is to determine if they are in the public interest. The following outlines the Committee's views as to the manner in which that determination is to be made.*

	The Committee ***recommends*** *that there be a three-part merger review process in order to determine if consolidation proposals are in the public interest.*
	
	• *Step 1 would require that the Competition Bureau be satisfied that any proposal does not violate the Competition Act and does not pose a threat to competition.*
	
	• *Step 2 would require that the Superintendent of Financial Institutions be satisfied that any proposal poses no safety and soundness concerns.*
	
	The Committee ***recommends*** *that remedial options be pursued actively and co-operatively with the consolidation proponents. These proponents should be able to respond in a timely fashion to any remedies put forward by the Competition Bureau or the Superintendent of Financial Institutions. Upon the successful completion of steps 1 and 2, the merger review process would proceed to the final step.*
	
	• *Step 3 would comprise a Public Interest Review Process, including a Public Interest Impact Assessment. The Task Force recommended that the following specific elements be included in this assessment:*
	
	    • *The costs and benefits to individual customers and SMEs;*
	
	    • *Regional impacts;*
	
	    • *International competitiveness;*
	
	    • *Employment, including both short-run and long-run effects as well as direct and indirect effects;*

	• *The adoption of innovative technologies;* • *Precedential impact.* *The Committee **recommends** that the Minister of Finance issue guidelines that would describe how the review process is to work and make clear what is expected of consolidation proponents. The process should satisfy the following three criteria:* • *It should be **transparent** so that the public can assess the benefits and costs of consolidation proposals.* • *It should be **efficient** so as not to delay the approval process and impose undue costs and uncertainty on participants.* • *It should be **co-operative** so that all parties could work together to ensure a solution to the benefit of all Canadians.* *The Committee endorses the Task Force view as to when step 3 would be required. Thus the Committee **recommends** that the Public Interest Review Process be required for all proposals that involve, or would create, institutions with more than $5 billion in equity. We further **recommend** that the Minister of Finance should also have the option of requiring a Public Interest Review Process for merger proposals involving smaller institutions. To ensure that the three objectives noted above are satisfied, it is important that the Minister issue guidelines so that financial institutions contemplating consolidation know precisely what is expected of them.* *The Task Force recommended elements that should be considered in such a review but did not suggest how it should be conducted. The Committee believes that it is important to specify the mechanics of this process.*

Empowering Consumers

General

53. An efficient, competitive marketplace requires that the market conduct practices of suppliers of financial services should be such as to ensure full, plain and adequate disclosure to consumers; fair, reasonable and non-abusive transaction practices; and adequate redress mechanisms to resolve disputes. Governments and financial institutions should work together to achieve those goals.

54. The federal government should ensure that market conduct regulation, within areas of its constitutional jurisdiction, embodies best practices, bearing in mind the criteria described in recommendation 53.

55. To ensure consistent market conduct treatment across Canada and across the spectrum of financial services providers, the federal government and the provinces should intensify harmonization and co-ordination efforts in respect of the standards of market conduct.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 53 to 55	*The Committee agrees that consumers must be empowered as proposed in recommendation 53. Enhanced consumer protection is a prerequisite for certain further reforms of the financial services sector. The Committee believes that the measures contained in the Task Force Report will have a dramatic impact on improving competition, by protecting consumers of financial institutions.* *The industry must demonstrate its commitment to enhanced consumer protection. The Committee* **recommends** *the creation of a Consumer Protection Bureau whose task it would be to promote consumer protection. The recommendations of the Finance Committee would create a consumer protection package designed to give consumers confidence that their interests are being protected. As noted in the commentary to recommendations 18 and 21, the Committee recommends that the government act quickly in putting into place an enhanced consumer protection regime.*

56. An efficient and competitive financial services marketplace requires continuing consumer vigilance and advocacy. To that end:

(a) The Task Force urges consumer advocacy groups to work together to pursue the concept of the establishment of a Financial Consumers Organization to ensure that there is effective consumer advocacy in the sector. Once a broad consensus of the groups is reached, governments and financial institutions should work with the sponsors to facilitate the organization's success.

(b) OSFI, the Department of Finance and Industry Canada should ensure that adequate resources are available to support project research on consumer issues and to fund relevant consumer advocacy groups to participate fully in important public policy initiatives relating to consumer protection, including those recommended in this report.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*There should be no direct government funding for consumer advocacy groups. The Committee* ***recommends*** *that Industry Canada examine ways in which consumer advocacy groups could raise funds from the public, including the insertion of information packages in the mailings of financial institutions.* *We further* ***recommend*** *that OSFI not be involved in this process.*

Disclosure and Transparency

57. Because the level of transparency in many financial services consumer contracts and marketing documents in Canada falls short of what Canadian consumers have a right to expect and industry is capable of delivering, financial institutions and their industry associations should intensify efforts to improve transparency and disclosure, using the following "best practices" guidelines:

(a) Timing: All essential information should be provided to the customer before a transaction is entered into, including the terms of the agreement between the provider and the customer.

(b) Presentation clarity: Documents should be presented in a manner which is capable of ready comprehension by a reasonably intelligent consumer in the marketplace.

(c) Organisational clarity: Documents should be formatted to highlight information that is important to the customer.

(d) Brevity: Documents should be as brief as possible, given the need for reasonable completeness from a commercial and legal perspective.

58. The federal government, working with the provinces, industry and consumer groups, should establish a multipartite Working Group to carefully review Canadian financial services contracts and marketing documents and to assess the extent to which Canadian institutions meet the best practices of transparency and disclosure. Where they fall short in a significant way, the Working Group should establish an action plan so that appropriate remedial action is taken, whether at the institutional level or by regulation. The Working Group should consider the feasibility of developing model forms for routine transactions, as has been done in other countries, and of establishing basic standards of document readability and comprehensibility.

59. Leaders of financial institutions should make increased disclosure and transparency high, visible corporate priorities, and should ensure that adequate resources are available to ensure best practices, including participation in the multipartite process described in recommendation 58. Institutions should set milestones and benchmarks against which to assess their progress, should monitor it by periodic user testing programs, and should report progress in their annual Community Accountability Statements described in recommendation 99.

60. Whenever governments review financial institutions or market conduct legislation on an ongoing basis, they should take all appropriate steps to improve disclosure and transparency. To that end, they should remove or reduce regulatory requirements that prevent the use of clear language, and should give positive reinforcement in law to the results reached by the multipartite Working Group.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 57 to 60	*Consumers cannot discern a good financial product from a bad one if contract language is complex or if relevant information is not available in a timely fashion. The Committee* ***recommends*** *that the government move quickly to see that "best practices" be used in financial contracts so as to improve disclosure and transpareency.*

61. Market conduct regulators, at both the federal and provincial levels, should audit financial institutions on a regular basis for best practices in respect of transparency and disclosure in transaction documents, in light of the benchmarking conclusions arising from the activities of the Working Group. OSFI should have this responsibility at the federal level.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*The Committee* ***recommends*** *that OSFI not be given the responsibility of enforcing transparency and disclosure requirements. In the same way the Committee does not agree with recommendation 112 (b) because of the potential conflict between the promotion of safety and soundness and the promotion of innovation, consumer protection and competition, this responsibility should be given to the new Financial Sector Ombudsman (as proposed in recommendations 76 to 80).*

62. To provide more adequate disclosure, fees and commissions paid to employees or third parties in respect of any financial services transaction should be required to be clearly disclosed before the transaction is entered into.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree in principle	*The Committee believes that consumers would benefit from greater disclosure of information. There are, however, many variables that determine the value to a customer of a financial product. It is possible that the disclosure of some fees and commissions could be misleading and give consumers a false sense of security. The Committee* ***recommends*** *further study to determine if such disclosure would be, on balance, in the best interests of consumers.*

63. There should be a statutory prohibition on contract terms that permit the unilateral amendment of financial services consumer contracts by financial institutions.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*A statutory prohibition of unilateral amendments to consumer contracts could be detrimental to consumers. It is legitimate for a firm to review its price structure and range of services. Unilateral changes are not necessarily negative. One could imagine new services (e.g. smart cards, telephone banking) being offered at no extra charge as part of a pre-existing service package. It is important not to ban unilateral contract amendments but make sure that the changes are fully disclosed at the appropriate time(as proposed in recommendations 57 to 60). It would be unworkable to attempt to ban unilateral changes that are detrimental to the consumer while allowing those that are beneficial. The Committee therefore* ***recommends*** *that there be no statutory ban.*

Privacy

64. The Task Force supports the announced intention of the Government to legislate a comprehensive privacy regime applicable to all commercial enterprises. With respect to financial institutions, we recommend that the legislation be based on the premise that privacy of personal information is a fundamental right. The legislation should prescribe Basic Minimum Privacy Standards.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Bill C-54, which implements a new privacy regime, should be expeditiously adopted by Parliament.*

65. The Basic Minimum Privacy Standards should include the following requirements:

(a) The customer should be able to specify the relationship the customer seeks with the financial institution and information collected should be specific to that relationship.

(b) The financial institution should specify what information may be sought from third parties. in accordance with the relationship sought by the customer.

(c) Customer consent to the collection, use or disclosure of information should be express and not implied, and the customer should be able to revoke or alter consent at a subsequent time.

(d) Target marketing should be subject to the customer's express agreement in writing.

(e) The customer should have access to the customer's personal information files and the right to require the correction of erroneous data.

66. Federally regulated financial institutions, either individually or through industry associations, should be required to develop an acceptable, legally binding privacy code, building upon the CSA Model Code and incorporating the Basic Minimum Privacy Standards. Provisions of the codes should expand the Basic Minimum Privacy Standards when appropriate. OSFI should have the responsibility to certify the codes of federally regulated financial institutions and to ensure that compliance is audited.

67. Medical information should receive special protection in the privacy regime. In particular:

(a) The same employee of a financial institution should not be engaged in both insurance sales and credit granting functions.

(b) There should be strict segregation within institutions of information collected for insurance and credit purposes.

(c) An insurance company should not be allowed to share medical information with a deposit-taking institution, whether or not it is affiliated, even with customer consent.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree in part	*These very stringent privacy safeguards are part of the package that is designed to deal with the concerns that might arise from enhanced powers for federally regulated financial institutions.* *The Committee* ***recommends*** *that OSFI not be given the responsibility certifying codes of conduct and ensuring that compliance is audited (as stated in recommendation 66). We* ***recommend*** *that the new Consumer Protection Bureau of the new Financial Services Ombudsman should be given this mandate.*

68. Consumers should have redress in respect of privacy matters to the financial services sector Ombudsman and, in addition, should have appropriate civil remedies, including punitive damages.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	

69. The federal government should work with provincial governments with the objective of ensuring that there is harmonized privacy legislation applicable to all regulated and unregulated providers of financial services in their dealings with individuals and small businesses. Provincial governments, where they have not already done so, should legislate a privacy regime which incorporates the Basic Minimum Privacy Standards.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	

Coercive Tied Selling

70. Because of the inequality of information and bargaining power between financial institutions and their customers, financial services legislation in all jurisdictions should unequivocally enshrine the freedom of financial services customers from coercion in their dealings with financial institutions.

71. There should be a specific legislative ban on coercive tied selling by banks and other financial institutions. With that aim, section 459.1 of the Bank Act should be proclaimed with amendments to broaden its scope to include all credit products, insurance and such other products or services as might be prescribed by regulation. Similar legislation should be applicable to all federally regulated financial institutions. As contemplated in section 459. 1, regulations should be passed to further elaborate on the statutory terms 11 "undue pressure" and "coercion."

72. Prior to entering into any financial services contract for the sale of insurance or the granting of credit, suppliers and intermediaries should be required to provide the customer with a clearly written description of what constitutes coercive tied selling and advice that coercive tied selling is not legal. The Government should work with industry and consumer groups to develop a common, easily understood notification statement.

73. The legislation should provide appropriate remedies for breach of the prohibitions against coercive tied selling, which would include prosecution, and private recourse through the ombudsman and court systems. Civil remedies should include punitive damages.

74. Suppliers and intermediaries should be required to ensure that every salesperson is trained to avoid coercive sales practices, including coercive tied selling. Initiatives such as the Canadian Bankers Association Code should be pursued.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 70 to 74	*Section 459.1 of the Bank Act was proclaimed into law upon the advice of this Committee. The Committee believes that coercive tied selling has become one of the more prominent concerns of financial sector customers. Coercion is about unequal power. It is as much about perception as it is about reality. The government should act rapidly on this set of recommendations that will greatly empower consumers and enhance their ability to shop around, thus limiting the ability of financial institutions to engage in abusive practices.*

75. Financial institutions should endeavour to itemize and price separately the different components of a package of services offered to customers which, under reasonable business practices, might be priced and sold separately.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*This would be a voluntary undertaking on the part of institutions who would provide such information only when it is reasonable to do so.*

Redress

76. Consumers of financial products and services should have improved means of private redress in the case of a dispute with a financial services provider, including a dispute arising from unfair or illegal market conduct practices.

77. Federal legislation should establish an Ombudsman office to which all federally regulated financial institutions and their subsidiaries would be required to belong.

78. The Ombudsman system should also be made available, on a voluntary basis, to provincially chartered and unregulated financial institutions. Provinces should require provincially regulated institutions to opt in to the Ombudsman system so that there would be a common redress system available to all Canadians, regardless of the financial institution with which they do business.

79. Each member financial institution should be required to make available an internal ombudsman who would be the first recourse for consumers.

80. The Ombudsman office should be structured in a way which will engender public confidence in its independence, mandate, accessibility and reliability, and which will be readily visible in the community. To that end:

(a) *In respect of independence:* The Ombudsman office should report to Parliament through the Minister of Finance. It should be under the management and direction of a board of directors, with representation from financial institutions, but with a majority of independent directors, all of whom would be appointed by the Minister of Finance. The board would appoint the Ombudsman, would approve funding arrangements, would recommend terms of reference of the Ombudsman for approval of the Minister, and would determine issues of policy.

(b) *In respect of mandate:* The mandate of the Ombudsman office should include all issues of fairness and maladministration by a financial institution, determined by reference to its legal obligations, good practice and the institution's established policies and practices.

(c) *In respect of accessibility:* Individual and small business customers should be able to access the system. Other customers should have access at the discretion of the Ombudsman. Costs of the Ombudsman office should be borne by the industry members on an assessment basis determined by the board of directors and approved by the Minister.

(d) *In respect of reliability:* Disputes should be resolved in a cost-effective, informal environment, entailing mediation where appropriate, and with the Ombudsman having the power to issue a ruling where mediation fails. To ensure cost-effective and non-legalistic proceedings, the rulings should not be binding. Any ruling of the Ombudsman which is not complied with by an institution should be made public, with the name of the defaulting institution and with appropriate protections to ensure the privacy of the complainant. Should financial institutions act in a manner to frustrate or impede the effectiveness of the Ombudsman process, including any persistent failure to follow the Ombudsman's recommendations, binding decisions should be considered.

(e) *In respect of visibility:* The existence and nature of the Ombudsman office, together with means of access to it, should be made widely known. Regulated financial institutions should be required to include information about the Ombudsman system, in an agreed format, in regular mailings to customers.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 76 to 80	*Every federally regulated financial institution should be obliged to put in place an internal ombudsman (as stated in recommendation 79).*

	The Committee encourages the provinces and the federal government to negotiate a memorandum of understanding so that the new Ombudsman can act both for federally and provincially regulated financial institutions (as proposed in recommendation 78). *To integrate all the complaints mechanisms under a single office for consumers (as proposed in recommendation 77) would be an important step in the right direction. Hence, the government should rapidly establish an Office of the Financial Sector Ombudsman.* *In respect of the mandate (recommendation 80 (b)), the new Ombudsman should be given the responsibility of promoting consumer protection issues and of auditing compliance. That office should also be responsible for the newly-created Consumer Protection Bureau.*

Proficiency Standards

81. Because an effective marketplace requires both that consumers be informed and that salespersons be well equipped to provide sound advice, there should be more effective training of persons who deal with the public in the sale of financial services products, including both intermediaries and employees of financial services institutions.

82. Well-defined and adequate proficiency standards should be adopted for market intermediaries, including a post-secondary diploma for new entrants, adequate examination standards and enhanced continuing education requirements.

83. Proficiency standards should be harmonized to the greatest possible extent across jurisdictions.

84. Given marketplace characteristics and consumer interests, the Task Force supports the regulation of financial services market intermediaries under provincial jurisdiction by a single regulator in each province.

85. Licensing restrictions for intermediaries based on occupation should be removed. Provincial governments should remove restrictions mandating full-time employment and should enter into reciprocal licensing agreements relating to residence of intermediaries, with the objective of improving service and lowering costs to the consumer.

86. The Task Force supports provincial review of:

(a) the current exemptions from provincial licensing requirements to determine whether those who benefit from the exemptions do in fact have training and supervision which is equivalent to the standards proposed for licensed market intermediaries: and

(b) the status and training of market intermediaries who are not currently covered by any proficiency regime even though they deal with retail consumers.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 81 to 86	*As the role of financial intermediaries evolves, the concept of a single regulator harmonizing the proficiency standards across all jurisdictions becomes more important.*

Canadians' Expectations and Corporate Conduct

General

87. There should be greater disclosure and transparency in respect of the performance of financial institutions in meeting community expectations. Government, institutions and concerned public interest groups should co-operate in identifying and resolving issues of unmet public expectations as they arise.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Better information would help financial institutions' ability to fulfil communities' high expectations.*

Responding to Expectations about Social Performance

Access

88. The Task Force affirms that access by low-income Canadians to basic transaction services of banks and other deposit-taking institutions is a very important policy objective, and it urges the Government, financial institutions and social interest groups to continue to work constructively together to attain it.

89. Federally regulated deposit-taking institutions should aggressively pursue the implementation of the agreements reached between the Government and major banks in

February and December 1997 concerning the opening of accounts and other access questions. Provincially regulated deposit-taking institutions should implement arrangements that are at least as effective.

90. To ensure access to basic banking services:

(a) The federal and provincial governments should make low-cost personal identification available to anyone requiring it, so as to eliminate problems of access arising from lack of satisfactory identification.

(b) Financial institutions, governments and social interest groups should work together to develop a common basket of services included in a standard basic account to be offered by all deposit-taking institutions. The basic account should recognize the impact of technology on basic banking services and, accordingly, should include a debit card as well as the right of the holder of a basic account to a specified number of withdrawals without additional charge.

(c) Deposit-taking institutions should make standard basic accounts available at reasonable charges. There is no need to legislate the price to be charged by financial institutions as long as the basic accounts are readily available at a reasonable price. From time to time, the Department of Finance should monitor the basic account prices charged to ensure that they remain reasonable.

(d) Deposit-taking institutions should be required to post prominently in each branch the terms and conditions of their most economic transaction account, together with the identification requirements needed to open one.

(e) In order to encourage access to accounts, governments should use direct deposit for all government programs that provide regular benefits. There should be provision for master accounts where appropriate. Although such programs should be optional for those who do not want to receive direct deposits, every effort should be made to encourage participation.

(f) To eliminate any reason for financial institutions to place holds on government cheques when adequate identification is presented, governments should implement indemnity programs with financial institutions pursuant to which low-income people, whether or not they are customers of the institutions, can gain immediate access to their funds. Financial institutions should ensure that there are no holds when indemnification agreements are in place.

(g) Financial institutions should continue to work with community groups to develop and implement effective training programs for staff, reinforced by incentive and compensation policies at the branch level, to ensure that the objectives of the February and December 1997 agreements on access are achieved.

91. The Task Force notes the absence of solid data on the number of "unbanked" in Canada and the reasons why persons remain outside the system. The Department of Finance should immediately undertake a careful survey to benchmark the extent and nature of the access problem so as to better develop public policy and enable financial institutions to be fully responsive. The Government should regularly monitor progress toward improved access through "mystery shopping" and other methods, and should repeat the benchmark survey at regular intervals.

92. Although the Task Force would prefer to see access problems resolved by a cooperative effort of governments, financial institutions, and social interest and community groups, it must be recognized that in a modern society access to financial services is of vital importance. Therefore, if significant progress is not made within a reasonably short time to resolve access issues, the Government should legislate the terms of the February and December 1997 agreements, with appropriate sanctions for non-compliance.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 88 to 92, except 90(a)	*All Canadians, whatever their socio-economic position, should have access to basic financial services at a reasonable price. As the sector evolves, this requirement will become even more crucial* *Recommendation 90(a) argues in favour of issuing personal identification to ease access to basic financial services . The Committee believes that this measure could lead to many abuses. The Committee* ***recommends*** *a public review before acting on this specific recommendation.*

Branch Services Access

93. In order to provide customers and affected communities with a reasonable time to adjust and seek alternative services when the branch of a deposit taking institution is to be closed:

(a) Federally regulated deposit-taking institutions should be required to provide at least four months' advance notice before closing branches. The notice should be posted prominently in the branch, communicated to all customers and relevant local authorities, and published in community newspapers.

(b) The financial institution should work proactively with the community to explore alternatives and to ease the transition.

(c) The Task Force urges provinces to consider a similar requirement for provincially chartered deposit-taking institutions.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee believes that four months notice is a reasonable period of time for notification and would be consistent with good business practice.*

Micro-Credit

94. The Task Force recommends that governments, financial institutions and community groups establish partnerships to promote micro-credit programs that assist individuals to establish and build new businesses and thereby contribute to self-employment.

95. Governments should participate in micro-credit by providing basic start-up and infrastructure support to pilot micro-lending programs that can demonstrate soundly based loan plans and that are unable to secure administrative financing from other sources. Governments should not fund loans under micro-credit projects.

96. Governments should review all social assistance programs to ensure that micro-credit loans do not reduce social assistance benefits, thereby creating a disincentive for individuals seeking self-reliance through micro-credit financing.

97. Banks and other financial institutions should be encouraged to develop partnerships with micro-credit programs in local communities. For example, credit-granting institutions could provide administrative support and know-how to micro-credit enterprises to develop systems, such as loan application evaluation procedures, or could fund program overhead costs.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 94 to 97	*Micro-credit has enormous potential in terms of community and individual development.*

Partnerships with the Voluntary Sector

98. Financial institutions should work with the voluntary sector to develop new, innovative partnerships that would help build stronger, healthier and more caring communities. Leaders in the financial institutions and in the voluntary sector should work together to this end, beginning with innovative pilot projects.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*New partnerships between financial institutions and the voluntary sector should be explored. If successful, these new initiatives could significantly improve the condition of our communities.*

Community Accountability Statements

99. Each federally regulated deposit-taking institution and life insurance company should be required to make available to the public and file with the Minister of Finance one or more annual Community Accountability Statements to describe its contribution to the community and to identify emerging community needs to which it intends to respond. The Minister should table all such statements with the Standing Committee of the House of Commons on Finance. The Community Accountability Statements will serve as the basis for a continuing dialogue between leaders of the financial institutions and the community.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*The Committee believes that such regulations would impose a disproportionately high cost on smaller institutions. It is not clear how the requirement would apply to monoline institutions and those operating from abroad.* *The Committee believes that it is in the best interests of financial institutions to make public their work in the community.* *The Committee* ***recommends*** *that mandatory Community Accountability Statements not be required. We* ***recommend*** *that financial institutions be required to provide statistics on their investment and lending activities. (See recommendation 101).* *The Committee believes that when the measures proposed by the Task Force related to the expectations about business financing are implemented (see recommendations 101 to 111), they will ensure that the financial institutions are responding to the business needs in the communities.*

100. Provincial governments should consider implementing similar requirements for Community Accountability Statements from financial institutions within their jurisdiction.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*See recommendation 99.*

Responding to Expectations about Business Financing

SME and KBI Finance Issues

101. The Government should undertake a substantial program of information collection and analysis to ensure that there is adequate information relating to the financing needs of small and medium-sized businesses (SMEs) for effective public policy development. To that end:

(a) Statistics Canada should collect data on the supply of debt and equity financing to small and medium-size enterprises, including in particular coverage of knowledge-based industries (KBIs), aboriginal enterprises, and other sectors or subsectors determined from time to time to be of particular public interest. The data collection program should cover all regulated and unregulated private- and public-sector financial institutions engaged in significant loan, lease, equity investment, or securitization activity in the small business market. Details of the information collection program, which should be comprehensive, should be determined by Statistics Canada in consultation with data providers, potential users in the community, and representatives of Industry Canada.

(b) Financial institutions should be required to publicly release their responses to Statistics Canada, with appropriate modifications to protect the confidentiality of commercial relationships.

(c) On a regular basis, Statistics Canada should publish compilations of the data collected for public review and analysis.

(d) Industry Canada should assume responsibility for coordinating an annual survey of SME attitudes to examine the availability of financing from the perspective of small businesses. The survey would be similar in concept to the studies currently being conducted under the auspices of the Canadian Bankers Association. The scope of the studies would be extended to cover all substantial providers.

(e) In addition, Industry Canada should conduct and publish periodic benchmark surveys of small business users, including knowledgebased firms, to provide a comprehensive benchmark picture of the financing they require and the sources

of finance upon which they rely, as markets evolve. An initial benchmark survey should be completed as soon as possible, and follow-up benchmark surveys should be conducted once every three to five years. These surveys would complement the annual information collected by Statistics Canada and Industry Canada.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee believes there is a lack of adequate date to support the establishment of effective SME initiatives. Resources should be made available for more data collection. Industry Canada should be responsible for the analysis of the collected data.*

102. The Task Force urges deposit-taking institutions, particularly banks, to find new and creative ways to address the problem in small business financing created by the frequent turnover of business account managers, including the establishment of career paths and compensation incentives that provide long-term meaningful careers for community-based SME account managers.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Committee believes that rapid turnover in account managers can adversely affect the inability of SMEs to build a strong and personal banking relationship.*

103. The Task Force urges banks to continue to decentralize decision making in respect of credit-granting authority and collection practices, including a meaningful delegation to the local level.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*If acted upon, this initiative should foster stronger relationships between SMEs and financial institutions.*

104. The Task Force urges Canadian financial institutions to be prepared to make credit available to higher-risk borrowers with more innovative financing packages and appropriate pricing.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*Canadian financial institutions should be encouraged to offer credit to higher-risk borrowers, priced accordingly.*

105. There should be more systematic and rigorous policy analysis of small business finance needs. To that end:

(a) An SME Finance Group should be established within Industry Canada to undertake continuing research on SME finance, including KBI enterprises. The SME Finance Group should oversee the user surveys, analyse the data collected by Statistics Canada and report annually to the Industry Committee of the House of Commons on the state of small business financing.

(b) The SME Finance Group should also pursue a program of special research on topical small business finance issues, such as the regional availability of finance, gender discrimination in SME finance, and aboriginal finance.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*See recommendation 101.*

106. In order to better understand the financing needs of knowledge-based industries, the SME Finance Group should give priority to the adoption of a common definition of "knowledge-based" industries" for purposes of data collection and analysis of the sector.

107. The Task Force urges financial institutions to pursue their recent KBI initiatives, with a focus on seed and venture capital, and to ensure a vigorous rate of investment in innovative KBI firms, subject to appropriate due diligence and prudential constraints.

108. The Industry Committee of the House of Commons should hold annual hearings on the state of KBI finance, at which the chief executive officers of the major banks would be invited to appear and update the Committee on the progress being made by their institutions to support the industries of the "new economy."

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 106 to 108	*The knowledge-based industry, which has the potential to transform the Canadian economy, faces unique financing problems. It is in the interest of Canadians for the federal government to be involved in enhancing access to capital for this sector.* *The Committee* ***recommends*** *that the Department of Finance investigate new initiatives that would enhance access to capital for SMEs and knowledge-based firms, both in terms of debt and equity financing.*

Financing Aboriginal Business

109. The Task Force endorses the recommendation of the National Aboriginal Financing Task Force that, subject to reasonable consensus within the aboriginal community, changes be made to federal legislation so that movable personal property situated on reserves may be used as security, thereby facilitating the provision of credit by financial institutions to aboriginal individuals and institutions.

110. The Task Force urges financial institutions to continue to pursue initiatives which are supportive of the economic development initiatives of aboriginal peoples and, for that purpose, to establish and maintain tailored, innovative financing programs.

111. The data collection programs to be undertaken by Statistics Canada and Industry Canada should include detailed information gathering on aboriginal financing issues to fill the void in data identified by the National Aboriginal Financing Task Force.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 109 to 111	*Financial institutions have already taken new initiatives relating to aboriginal financing. New measures would have a positive impact on aboriginal Canadians.*

Improving the Regulatory Framework

OSFI Mandate and Governance

112. There should be revisions to the OSFI statutory mandate to better describe its ongoing responsibilities with regard to the federally regulated financial services sector.

(a) OSFI should have a clearly defined statutory responsibility to administer the consumer protection provisions of federal financial institutions legislation, including legislation in respect of disclosure and transparency, privacy and coercive tied selling.

(b) Given the importance of effective competition in the Canadian financial services sector and the rapidly changing competitive environment, the OSFI mandate should be revised to make it clear that OSFI has the responsibility to balance competition and innovation considerations with its present statutory obligations in respect of safety and soundness.

(c) It should be made clear in the OSFI mandate that OSFI is required to protect the rights and interests of depositors and policy holders, but that it has no special responsibility to other creditors of financial institutions.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*The Committee* ***recommends*** *that OSFI's statutory obligations not be expanded to include consumer protection issues, competition and innovation. There is a clear conflict between these objectives and safety and soundness. OSFI's mandate should focus on prudential concerns, although its actions should not restrict competition and innovation.* *The Committee* ***recommends*** *that a Consumer Protection Bureau be established, and be responsible to the new Financial Services Ombudsman. It would be the job of this CPB to promote consumer protection.* *Enhancing competition and competitiveness should be an overall goal of government policy. It does not require an agency or department to oversee this goal.*

113. The governance structure of OSFI should be strengthened to make it more appropriate to the increasingly complex needs of regulation and its revised mandate. To that end:

(a) The OSFI Act should be amended to provide for a board of directors for OSFI, made up of a majority of independent directors, including experienced independent businesspeople and persons familiar with consumer issues, together with the Superintendent of OSFI, the Chair of CDIC, the Governor of the

Bank of Canada and the Deputy Minister of Finance. An independent director should serve as board chair.

(b) The board of directors would be responsible for:

(i) overseeing how OSFI conducts its business and administrative affairs;

(ii) approving major OSFI policies and strategies;

(iii) monitoring the achievement by OSFI of progress against its strategic plans and statutory mandate; and

(iv) ensuring that there is effective senior management, particularly in the position of the Superintendent, who should be appointed by the Minister of Finance on the recommendation of the OSFI board.

COMMITTEE'S RESPONSE:	COMMENTARY
Disagree	*The Committee believes that a Board of Directors for OSFI might undermine the powers of the Superintendent and the Minister of Finance. It could also affect the accountability channels that link the Superintendent to the Minister. We* ***recommend*** *that a board of directors model not be initiated at this time.*

Regulatory Overlap

114. To eliminate regulatory overlap at the federal level, OSFI should have the sole responsibility for promoting standards of sound business and financial practices in financial institutions and for establishing policies and procedures to manage and control risk. To that end, the present overlapping statutory mandate of CDIC on these subjects should be repealed. OSFI should collaborate closely with CDIC in establishing business standards, financial practices and risk management policies, and should act on behalf of CDIC in monitoring compliance.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*The Task Force believes that all supervisory functions should be centralized in OSFI and the Committee concurs with the recommendation. CDIC should take initiatives that are appropriate for an insurer. CDIC's role in setting standards for business and financial practice should migrate to OSFI.*

115. Governments should work aggressively to eliminate overlap in prudential regulation, both between the federal and provincial governments and among provincial governments. To that end:

(a) In consultation with provincial regulators, OSFI should establish a central, electronic data base which would permit common reporting formats and single-window electronic filings.

(b) The provinces should be encouraged to delegate solvency regulation of trust, loan and life insurance companies to OSFI so that, over time, prudential regulatory responsibilities for financial institutions could be consolidated in a single, well-resourced, and experienced regulator, applying common practices and international standards.

(c) To the extent that delegation cannot be achieved, the federal government and the provinces should harmonize the laws and regulations relating to trust, loan and insurance companies, including in particular the development of common capital adequacy tests and the recognition of home-jurisdiction regulation.

116. Regulatory procedures at the federal level should, wherever practicable, be streamlined. Among other things:

(a) Approvals of regulatory action should be taken at appropriate levels within government. Wherever practicable, the Superintendent of OSFI should be mandated to provide approvals without the need for referral to the Minister of Finance, except where matters of policy are involved.

(b) Decisions on the entry into Canada of foreign banks should, in routine cases, be made by the Superintendent of OSFI rather than the Governor-in-Council. Only in cases involving significant policy issues should the approval of the Minister of Finance be required.

(c) Wherever possible, approvals should be replaced with notice filings or eliminated entirely for non-material matters and in other circumstances in which there is little or no prudential risk.

(d) Mechanisms such as blanket or consolidated approvals and fast-track approvals or advance rulings should be developed to streamline the regulatory process.

To implement this proposal, a committee should be struck with representation from OSFI, the Department of Finance and the affected financial services industries to review streamlining options, with priority to be given to easing requirements which entail the greatest regulatory burden.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 115 and 116	*The federal government and OSFI should work closely with their provincial counterparts to seek acceptable ways to resolve the regulatory overlap.*

Consumer Insurance Plans

117. In order to promote effective competition between banks and insurers, to eliminate public confusion and to provide equivalent protection to Canadians, regardless of their choice of financial services provider, the insurance plans for federally insured deposit-taking institutions and life insurers should be amalgamated. The Task Force proposes that one of two possible models be adopted:

(a) The continuation of the Canada Deposit Insurance Corporation (CDIC) as a Crown corporation, with access to the Consolidated Revenue Fund, but with an expanded scope to cover the activities now conducted by the Canadian Life and Health Insurance Compensation Corporation (CompCorp).

(b) A new independent organization, established by statute and with provision for a liquidity backup borrowing authority from the Consolidated Revenue Fund, but without Crown corporation status.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree	*As life insurance companies and deposit-taking institutions increasingly converge in terms of the products they offer, it is important that the consumer compensation arrangements do not favour one set of institutions over another. The Task Force did not conclude which of the various models is the most appropriate to resolve this problem. The Committee* ***recommends*** *further study to determine the best model to achieve its goal. The privatization of CDIC should also be considered as a possibility.*

118. The amalgamated insurance plan would, in the first instance, maintain separate pre-funded insurance pools for deposit-taking institutions and for life insurers. It would also have the mandate to review and, where possible, to develop a common framework for priorities in insolvency, product coverage and other matters where there are now different legal rules or differing CDIC and CompCorp policies.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree in principle	*See recommendation 117. If amalgamation is determined to be the appropriate approach, the Committee supports this recommendation.*

Provision of financial Services from Outside Canada

119. The Bank Act should be amended to make it clear that all providers of financial services that undertake mass solicitations or target marketing of financial services to Canadians without establishing a physical presence in Canada are required to comply with federal financial institutions legislation. For a lender, such compliance would entail the need to obtain certification from OSFI, which would be available upon the lender's filing a binding undertaking to comply with consumer protection rules applicable to banks in Canada, to disclose that it is not regulated in Canada, and to provide a mechanism for dispute resolution in Canada.

120. The certification process would not be available to financial services companies wishing to take deposits from, or sell insurance products to, Canadians from outside Canada. Such providers would continue to be required to conduct these activities through a regulated Canadian subsidiary or branch.

121. The Task Force affirms its belief that an important element of consumer protection in an age of electronic service providers will be the provision of timely and accurate information, designed to inform consumers accurately about the status of providers. To that end, OSFI should regularly publish on its Web site, and periodically make visible to Canadians through other appropriate media and means, accurate information whereby consumers will be able to know:

(a) the companies that are regulated by OSFI or other Canadian regulators;

(b) the companies that do not have a physical operation in Canada but have obtained OSFI certification of their lending activities to Canadians; and

(c) the companies which OSFI believes to be offering financial services to Canadians illegally.

122. Industry Canada, as part of its deliberations to develop an appropriate framework for electronic commerce, should consider deeming Internet providers of financial services to have agreed to permit dispute resolution in Canadian courts and by the application of Canadian law, thereby providing Canadians who are wronged by such providers located outside Canada with a means of redress in Canada.

123. OSFI should actively participate in international discussions designed to develop an appropriate regulatory regime applicable to trans-border Internet providers of financial

services so that Canadian law and regulatory practice, in a timely manner, incorporate international best practices to protect Canadian consumers.

124. Canada should continue to play an active role in international initiatives to improve standards and processes for the regulation of financial institutions and, where required, should make timely changes to Canadian financial sector legislation and regulatory practices to implement international best practices.

COMMITTEE'S RESPONSE:	COMMENTARY
Agree with recommendations 119 to 124	*Canadians should have full access to "virtual" financial services from outside our borders. The Committee believes that what is proposed by the Task Force will create an international regulatory regime, develop a framework for electronic commerce, provide information to consumers about the status of providers and a certification process for foreign virtual financial institutions operating from abroad.* *The Committee agrees that, until international arrangements are in place, virtual foreign institutions should not be allowed to take deposit, unless there is a regulated Canadian subsidiary or branch (i.e. they must have a physical presence in Canada). This will protect consumers and ensure the safety and soundness of our financial services sector.* *The Committee* ***recommends*** *that the federal government enter into negotiations with the United States to provide national treatment to customers of financial institutions. This way Canadian residents could enjoy all the regulatory protections (including deposit insurance protection) offered to American residents. Canadian consumers would have a wider access to virtual financial service providers. Increased competition would translate into increase choices and lower prices.*

APPENDIX A
List of Witnesses

Organizations and Individuals	Date
Task Force on Future of the Financial Services Sector	**Monday, September 21, 1998**
Pierre Ducros, Vice-Chairman	
Fred Gorbet, Executive Director	
Harold MacKay, Chairman	
Royal Bank of Canada	
John Cleghorn, Chairman and Chief Executive Officer	
Canadian Bankers' Association	**Thursday, September 24, 1998**
Raymond Protti, President and Chief Executive Officer	
Alan Young, Vice-President, Policy	
"Industrielle Alliance"	
Yvon Charest, Executive Vice-President	
Standard Life Insurance Company	
Claude Garcia, President and Chief Executive Officer	
Bank of Montreal	**Friday, September 25, 1998**
Matthew W. Barrett, President and Chief Executive Officer	
Tim J. O'Neill, Chief Economist	
Andrew White, Executive Vice-President Corporate Services	
Canadian Community Reinvestment Coalition	
Duff Conacher, Chair, CCRC and Coordinator Democracy Watch	
Dundee Bancorp Inc.	
Donald K. Charter, Executive Vice-President	
Ned Goodman, Chairman, President and Chief Executive Officer	

Organizations and Individuals	Date
Insurance Bureau of Canada	**Friday, September 25, 1998**
George D. Anderson, President and Chief Executive Officer	
Mark Yakabuski, Vice-President, Government Relations	
Investment Funds Institute of Canada	
John Kaszel, Director, Academic Affairs and Research	
Acorn Partners	**Tuesday, September 29, 1998**
Peter Kemball, Managing Director	
Canadian Association of Factors and Credit Insurers	
Mark Perna, Chairman	
Michael Teeter, Director, Industry Government Relations Group	
Canadian Automobile Dealers Association	
J.A. Gérald Drolet, President, Automobiles Plymouth Chrysler de Laval Ltée	
Huw Williams, Director, Public Affairs	
Canadian Taxpayers' Federation	
Walter Robinson, Federal Director	
Canadian Vehicle Manufacturers' Association	
Peter R. Andrew, Director of Operations General Motors Acceptance Corporation of Canada Ltd. (GMAC)	
Mark Nantais, President	
Michael Sheridan, Director, Government Relations, Ford Motor Company of Canada Ltd.	
Capital One Financial Corporation	
Christopher T. Curtis, Associate General Counsel	
David M. Willey, Senior Vice-President and Treasurer	
First Union Corporation	
Wayne Ehgoetz, Head, Canadian Operations	

Organizations and Individuals	Date
ING Direct	**Tuesday, September 29, 1998**
Arkadi Kuhlman, President and Chief Executive Officer	
Norwest Financial/Trans Canada Credit	
Richard Owens, President	
Steve R. Wagner, Assistant General Counsel	
Regional Group of Companies	
Leonard Potechin, Chairman of the Board	
Toronto-Dominion Bank	
A. Charles Baillie, President and Chief Executive Officer	
Robert P. Kelly, Vice-Chairman	
Wells Fargo Bank	
Gadi Meir, Assistant Vice-President, Business Development	
"Association des intermédiaires en assurance de personnes du Québec"	**Wednesday, September 30, 1998**
Anne-Marie Beaudoin, Acting General Director	
Alain Poirier, President	
Canadian Association of Insurance and Financial Advisors	
Robert Fleischacker, Chairman	
David Thibaudeau, President	
Credit Union Central of Canada	
Bill Knight, President and Chief Executive Officer	
Bobby McVeigh, Chairman of the Board	
Independent Life Insurance Brokers of Canada	
Jim Bullock, President	
Pat Chamberlain, President	

Organizations and Individuals	Date
Insurance Brokers Association of Canada	**Wednesday, September 30, 1998**
Jim Ball, President-Elect	
Robert Ballard, Vice-President	
Rick Frost, Chairman	
Mabel Sansom, Executive Director	
Dan Tessier, Director, Public Affairs	
Mike Toole, President-Elect	
Power Corporation of Canada	
James W. Burns, Deputy Chairman	
Edward (Ted) Johnson, Vice-President	
Great-West Life and London Life Insurance	**Thursday, October 1, 1998**
Al Edwards, Senior Vice-President and Actuary	
Ray L. McFeetors, President and Chief Executive Officer	
Sheila A. Wagar, Senior Vice-President General Counsel and Secretary	
British Columbia Task Force on Bank Mergers	**Tuesday, October 6, 1998**
Marjorie Griffin Cohen, Professor of Political Science and Women's Studies, Simon Fraser University	
Blair Lekstrom, Small businessman Mayor of Dawson Creek, Member Chamber of Commerce of British Columbia	
David Rosenberg, Chair, Partner, Rosenberg and Rosenberg	
Citizens Bank	
Brian Carroll, Consultant	
Cordillera Books/Richmond Book Services	
S.C. Heal, Proprietor	
Credit Union Central of British Columbia	
Wayne A. Nygren, President and Chief Executive Officer	
Richard Thomas, Government Operations and Corporate Secretary	

Organizations and Individuals	Date
Fraser Institute	Tuesday, October 6, 1998
Jason Clemens, Policy Analyst	
Fazil Milhar, Director of Regulatory Studies	
IFC Vancouver	
Liam Hopkins, Executive Director	
Alan Vichert, Assistant Director	
Insurance Brokers Association of British Columbia	
Brent Atkinson, Atkinson, Terry, Insurance Brokers	
Roger Finnie, Director	
Michael Megson, President	
Insurance Brokers Association of Newfoundland Inc.	
Brian Flemming, Treasurer	
John P. Thompson, President	
Jeff Wedgewood, Secretary	
Kerry Financial Corporation	
Chris O'Toole, President	
Royal Bank of Newfoundland and Labrador	
Sam Walters, Vice-President	
Southern Cross Sheepskins Inc.	
Ashley Dermer, President	
Vancouver Board of Trade	
Darcy Rezac, Managing Director	
As Individuals	
Paul Bowles, Department of Economics University of Northern British Columbia	
Ian C. MacLeod, Lawson, Lundell and McIntosh, Barristers and Solicitors	
"Université Sainte-Anne"	Wednesday, October 7, 1998
Gérald C. Boudreau, General Secretary and Registrar	

Organizations and Individuals	Date
Alberta Women's Enterprise Initiative Association	**Thursday, October 8, 1998**
Corinne Tessier, Executive Director	
Amherst Consultants Ltd.	
Lois Mitchell, President	
Bolt Supply House Ltd.	
John McCann, President	
Centre for Women in Business	
Daurene E. Lewis	
Davis Strait Fisheries Ltd.	
Grant Stonehouse, President	
Hi-Alta Capital Inc.	
Ken Hughes, Director and Chief Financial Officer	
Scott Tannas, President and Chief Executive Officer	
Innovacorp	
Lorne Ferguson, Executive Director	
Insurance Brokers' Association of Nova Scotia	
Stephen Greene, Executive Director	
Bruce Lipsett, President	
Metropolitan Halifax Chamber of Commerce	
Nancy Conrad, Assistant General Manager Policy Manager	
Terry Norman, Chair of the Bankmerger Task Force	
O'Regan National Leasing	
Paul O'Regan, Owner	
Stephen O'Regan, Owner	
Peace Hills General Insurance Company	
Diane M. Strashok, President and Chief Executive Officer	
World Sceptre Challenger	
David Peddle, Founder	

Organizations and Individuals	Date
As Individual	**Thursday, October 8, 1998**
Bill Casey, M.P., Progressive Conservative Party	
Alberta Securities Commission	**Friday, October 16, 1998**
William L. Hess, Chair	
Canadian Association of Retired Persons	
Bill Gleberzon, Assistant Executive Director	
Canadian Fraternal Association	
Ralf Hensel, Chairman	
Richard May, Vice-President	
Co-operators Group	
Maurice Campeau, Director, Region of Alberta and Second Vice-Chair	
Laura Gregson	
Frank Lowery, Vice-President, General Counsel and Secretary	
Donna Stewardson	
Committee on Monetary and Economic Reform	
William Krehm, Chairman	
Credit Union Central of Ontario	
Jonathan Guss, President and Chief Executive Officer	
Davis Webb Schulze & Moon	
Christopher Moon, Barrister and Solicitor	
Dominion of Canada General Insurance Company	
George L. Cooke, President and Chief Executive Officer	
Durham College	
Gary Polonsky, President	
Fluke Transportation Group	
Ron Foxcroft, President	

Organizations and Individuals	Date
Fort York Small Business Association	**Friday, October 16, 1998**
John Banka, Member, Treasurer of Toronto Small Business Organization / Yonge Street Mall Business Association	
Rosario Marchese, Chairman, M.P.P.	
Fox 40 International Inc.	
Ron Foxcroft, President	
Guarantee Company of North America	
Robert Dempsey, Senior Vice-President	
Jules R. Quenneville, President and Chief Executive Officer	
Hogan Group	
Michael A. Hogan, President	
Insurance Brokers Association of Ontario	
Robert J. Carter, Director, Member of the Executive Committee	
Gil Constantini, President-Elect	
Investment Dealers Association of Canada	
Joseph Oliver, President and Chief Executive Officer	
Ian Russell, Senior Vice-President, Capital Markets	
Islamic Financial Institutions, Canada	
Abdalla Ali, Vice-Chairman, Member of the Committee	
Shameela Chinoy, Member of the Committee	
Said Zafar, Chairman	
Life Spin — Women's Resource Centre	
Andrew Bolter, Director, Community Development Programs	
McArthur & Company Publishing Limited	
Kim McArthur, President and Publisher	
Newcourt Credit Group	
David Banks, Chairman	

Organizations and Individuals	Date
Ontario Securities Commission	Friday, October 16, 1998
David Brown, Chairman	
Self-Employment Development Initiatives	
Peter Nares, Executive Director	
Toronto Small Business Support Organization / Yonge Street Mall Business Association	
Susan Bellan, Member	
Trimark Investment Management Inc.	
William Harker, Chair, Trimark Trust	
Trust Companies Association of Canada	
Joseph Chertkow, Director, Legislation and Policy	
William Harker, Vice-Chairman	
Gerald Soloway, Chairman	
Women and Rural Economic Development	
Carol Rock, Executive Director	
As Individual	
Michael MacKenzie, Professor, York University Former Head of the Office of the Superintendent of Financial Institutions Canada	
Canadian Federation of Independent Deposit Brokers	Tuesday, October 20, 1998
Jack Rothemberg, Committee Member	
Canadian Western Bank	
Larry M. Pollock, President and Chief Executive Officer	
Duchin, Bayda and Kroczynski Barristers and Solicitors	
Bernard Duchin, Partner	
First Nations Bank of Canada	
Keith G. Martell, Chair of the Board of Directors	
David Ross, President and Chief Operating Officer	

Organizations and Individuals	Date
Insurance Brokers Association of New Brunswick	**Tuesday, October 20, 1998**
René Bourque, President-Elect	
Linda Dawe, Executive Director	
Paulette Holder, President	
Insurance Brokers Association of Saskatchewan	
Louis Lafrance	
Randy Parker, Past President	
Barb Ricard, President	
Maritime Association of Mutual Insurance Companies	
Ray White, Director	
McDonalds Restaurants of Saint John and Quispansis	
Glen Calkins, Owner-operator	
Right Choice Computers Inc.	
Twyla Jensen, President	
Bühler Industries Inc.	**Thursday, October 22, 1998**
John Bühler, President	
Canadian Finance and Leasing Association	
Nick Logan, President, National Leasing Group, Winnipeg, Manitoba	
David Powell, President	
Tom A. Simmons, Chairman	
Council of Canadians	
Leo Broderick, Member of the Board of Directors	
Energy Consultants International Inc.	
David Farlinger, President and Principal	
James Sandison, Principal	
Fair Isle Ford Sales Ltd.	
Myron MacKay	

Organizations and Individuals	Date
Farm Credit Corporation	**Thursday, October 22, 1998**
Armand Leclerc, AVP, Farm Financing Manitoba	
John Ryan, President and Chief Executive Officer	
"Fédération des parents de l'Île-du-Prince-Édouard"	
Ulysse Robichaud, President	
GE Capital Canada	
Michael Davies, Vice-President and General Counsel	
Roman Oryschuk, President and Chief Executive Officer, (Equipment Financing)	
Robert Weese, Vice-President, Government and External Relations	
Hyndman & Company Ltd.	
Fred Hyndman, Managing Director	
Insurance Brokers Association of Manitoba	
Gerry Corrigal, Vice-President	
Brent Gilbert, Past President	
Insurance Brokers Association of Prince Edward Island	
Jeff Cooke, President	
Dan McInnis, Treasurer	
Man-Shield Construction Inc.	
Joe Bova, Manager	
Official Opposition of P.E.I. (Liberal Party of P.E.I.)	
Robert Morrissey, MLA, Finance Critic	
P.E.I. Mobile Home and Trailer Sales	
H. Wayne Hambly, General Manager	
P.E.I. Mutual Insurance Company	
Terry Shea, Secretary Treasurer	
Portage La Prairie Mutual	
T.W. McCartney, Vice-President	

Organizations and Individuals	Date
Ramboc Enterprises	**Thursday, October 22, 1998**
Tom Struthers, President and Owner	
Shelter Canadian Properties Limited	
Arni C. Thorsteinson, President	
TelPay — A Division of CTI-Com Tel Inc.	
William H. Loewen, President, TelPay Bill Payment Service	
Wawanesa Mutual	
Ken E. Mitchell, Branch Manager	
Canadian Imperial Bank of Commerce	**Monday, October 26, 1998**
A. L. Flood, Chairman and Chief Executive Officer	
Holger Kluge, President, Personal and Commercial Bank	
As Individuals	
Odina Desrochers, M.P., Bloc Québécois	
Yvan Loubier, M.P., Bloc Québécois	
Bank of Canada	**Tuesday, October 27, 1998**
Charles (Chuck) Freedman, Deputy Governor	
Clyde Goodlet, Regulatory Policy Advisor	
Gordon Thiessen, Governor	
Consumers' Association of Canada	
Jennifer Hillard, Vice-President, Issues and Policy	
Gail Lacombe, President	
Hongkong Bank of Canada	
Youssef A. Nasr, President and Chief Executive Officer	
Insurance Consumers Group	
William R. Podmore, Executive Director	
Laurentian Bank of Canada	
Henri-Paul Rousseau, President and Chief Executive Officer	

Organizations and Individuals	Date
London Life Policyholders' Association	**Tuesday, October 27, 1998**
June Davies, Co-Director of Education for LLPA and Canadian Life Insurance Policyholders Association	
Leland Davies, Director of Education for LLPA and Canadian Life Insurance Policyholders Association	
Anne Holmes, Founding Chair of LLPA and Canadian Life Insurance Policyholders Association	
Mutual Group	
Robert Astley, President and Chief Executive Officer	
National Council of Welfare	
Steve Kerstetter, Director	
"Option Consommateurs"	
Louise Rozon, Executive Director	
Jacques St-Amant, Analyst	
Public Interest Advocacy Centre	
Angie Barrados, Researcher	
Sun Life Assurance Company of Canada	
Donald Stewart, President and Chief Executive Officer	
Scotia Bank	**Thursday, October 29, 1998**
Peter C. Godsoe, Chairman and Chief Executive Officer	
Canada Deposit Insurance Corporation	
Grant L. Reuber, Chairman of the Board	
Jean-Pierre Sabourin, President and Chief Executive Officer	
Canada Life	
David A. Nield, President and Chief Executive Officer	
Canadian Investor Protection Fund	
Rozanne E. Reszel, President and Chief Executive Officer	

Organizations and Individuals	Date
Canadian Life and Health Insurance Association Inc.	**Thursday, October 29, 1998**
Mark Daniels, President	
Chris McElvaine, Chairman, President and Chief Executive Officer, Empire Life	
Greg Traversy, Executive Vice-President Policy Development	
Canadian Life and Health Insurance Compensation Corporation	
Gordon M. Dunning, Executive Vice-President	
Alan E. Morson, President	
Canadian Payments Association	
Robert Hammond, General Manager	
Doug Kreviazuk, Director, Policy and Planning	
Council of Canadians	
Peter Bleyer, Executive Director	
Jamie Dunn, Representative	
INTERAC Association	
Fred Harris, Senior Vice-President, Service Delivery	
Marc-André Lacombe, Corporate Secretary and Legal Counsel	
Judith Wolfson, President	
Manulife Financial	
Dominic D'Alessandro, President and Chief Executive Officer	
National Bank of Canada	
Léon Courville, President, Personal and Commercial Bank and Chief Operating Officer	
Dominique Vachon, Vice-President and Senior Economist	

Organizations and Individuals	Date
Office of the Superintendent of Financial Institutions Canada	**Thursday, October 29, 1998**
Nicholas LePan, Deputy Superintendent (Supervision)	
John R.V. Palmer, Superintendent	
As Individual	**Friday, October 30, 1998**
André Lizotte	
Association of Life Insurers (Quebec Charter)	**Tuesday, November 3, 1998**
Jean La Couture, Spokesman	
Canadian Corporate Funding Limited	
Paul J. Lowenstein, Chairman	
"Coalition québécoise pour le maintien des emplois et services bancaires personnalisés"	
Serge Cadieux, "Syndicat, Banque Laurentienne"	
Clément Godbout, President, "Fédération des travailleurs et travailleuses du Québec (FTQ)"	
Gérald Larose, President, "Confédération des syndicats nationaux"	
Hans Marotte, "Mouvement Action-chômage"	
Jacques St-Amant, Analyst, "Option Consommateurs"	
"Confédération des caisses populaires et d'économie Desjardins du Québec"	
Jean-Guy Langelier, President and Head of the "Caisse centrale Desjardins"	
Yves Morency, Secretary of Governmental Relations	
Huu Trung Nguyen, First Vice-President, Administration and Exploitation, "Caisse centrale Desjardins"	
"École des Hautes Études Commerciales"	
Jean Roy, Associate Professor of Finance	

Organizations and Individuals	Date
Entraide, Mutual Life Insurance Company	**Tuesday, November 3, 1998**
Gaëtan Gagné, President and Chief Executive Officer	
HGB Associates	
Harry Baumann, President	
"Institut québécois de planification financière"	
Anne-Marie Girard Plouffe, Executive Committee Member	
Réjean Ross, President	
Montreal Automobile Dealers Corporation	
Jacques Béchard, President and Chief Executive Officer, "Corporation des concessionnaires d'automobiles du Québec"	
Jean-Paul Lalonde, Vice-President "Corporation des concessionnaires d'automobiles de Montréal" and President Contact Pontiac Buick Inc.	
Roxanne Longpré, Executive Vice-President "Corporation des concessionnaires d'automobiles de Montréal"	
Gilles Richard, Former President, "Corporation des concessionnaires d'automobiles de Montréal" and President, Le Circuit Mercury (1977) Ltd.	
Quebec Association for the Protection of Savers and Investors Inc.	
Réjean Belzile, President of the Study Committee	
Paul Lussier, Vice-President	
Yves Michaud, President	
Alliance of Manufacturers & Exporters Canada	**Wednesday, November 4, 1998**
Jayson Myers, Senior Vice-President and Chief Economist	
Matthew Wilson, Policy Analyst	

Organizations and Individuals	Date
Banca Commerciale Italiana of Canada	**Wednesday, November 4, 1998**
Gennaro Stammati, President, Chair and Chief Executive Officer, Foreign Banks Executive Committee, Canadian Bankers Association	
Canada Trust	
Edmund Clark, President	
Greta Wemekamp, Assistant Vice-President Government Relations	
Canadian Bankers' Association	
Jeffrey Graham, Lawyer, Borden Elliot	
William Randle, Assistant General Counsel and Foreign Bank Secretary	
Gennaro Stammati, Chair and Chief Executive Officer, Foreign Banks Executive Committee and President of Banca Commerciale Italiana	
Canadian Retail Building Supply Council	
Stephen Johns, President	
Pixie Bigelow Productions Inc.	
Pixie Bigelow, President and Documentary Film-Maker	
Retail Council of Canada	
Diane J. Brisebois, President and Chief Executive Officer	
SNC-LAVALIN Inc.	
Jacques Lamarre, President and Chief Executive Officer	
Robert Racine, Senior Vice-President, Public Affairs and Investor Relations	
Aboriginal Banking	**Thursday, November 5, 1998**
Ron Jamieson, Senior Vice-President	
AGF Management Ltd.	
Blake C. Goldring, President and Chief Executive Officer	

Organizations and Individuals	Date
Association of International Automobile Manufacturers of Canada	**Thursday, November 5, 1998**
Adrian Bradford, Associate Executive Director	
Gino Cozza, Chair, Financial Services Committee	
Business Development Bank of Canada	
François Beaudoin, Chair and Chief Executive Officer	
Michel Vennat, Chair of the Board	
Canadian Association of Financial Institutions in Insurance	
Bernard Dorval, Vice-Chair	
H. Dunbar Russel, Chair	
Canadian Banking Ombudsman	
Peggy-Anne Brown, Chair, Board of Directors	
Michael Lauber, President	
Jim Savary, Member, Board of Directors	
Canadian Direct Marketing Association	
John Gustavson, President and Chief Executive Officer	
Canadian Heritage Foundation	
Brian Anthony, Executive Director	
Douglas Franklin, Director, Government and Public Relations	
Heraclitus Corp.	
Howard M. Greenspan, President	
MacKenzie Financial Corporation	
Allan Warren, President, MRS Trust Company	
National Council of Women of Canada	
Elizabeth Hutchinson, President	
Shirley McBride, Economics Convener	
Helen Saravanamuttoo, Vice-President	

Organizations and Individuals	Date
Sharwood and Company	**Thursday, November 5, 1998**
Gordon Sharwood, President	
Trimark Investment Management Inc.	
Kathleen Young, Vice-President and Treasurer	
Canadian Association of Mutual Insurance Companies	**Friday, November 6, 1998**
Normand Lafrenière, President	
Canadian Federation of Independent Business	
Brian Gray, Senior Vice-President, Policy and Provincial Affairs	
Catherine Swift, President and Chief Executive Officer	
Garth Whyte, Vice-President, National Affairs	
National Action Committee on the Status of Women	
Sandra Carnegie-Douglas, Executive Coordinator	
Results Canada	
Richard Ernst, Board Member	
Rice Financial Group Inc.	
Thomas J. Rice, President and Chief Executive Officer	
University of Ottawa	
Alain Parquez, Economics Department	
As Individuals	
Arthur Donner, Economist and Consultant	
Douglas D. Peters, P.C., Financial and Economic Consultant and Former Secretary of State for Financial Institutions	

Organizations and Individuals	Date
Canada Post Corporation	**Monday, November 16, 1998**
L. Philippe Lemay, Senior Vice-President Electronic Products and Services	
André Ouellet, Chairman	
Michel Tremblay, Vice-President, Retail Business	

APPENDIX B
List of Submissions

Aboriginal Banking

Acorn Partners

AGF Management Limited

Alberta Women's Enterprise Initiative Association

Amherst Consultants Ltd.

"Association des consommateurs du Québec"

"Association des intermédiaires en assurance de personnes du Québec"

Association of Canadian Financial Corporations

Association of International Automobile Manufacturers of Canada

Association of Life Insurers (Quebec Charter)

Banca Commerciale Italiana of Canada

Bank of Canada

Bank of Montreal

Scotia Bank

Bitney and Company

Gérald Boudreau

British Columbia Task Force on Bank Mergers

Business Development Bank of Canada

Canada Deposit Insurance Corporation

Canada Life

Canada Trust

Canadian Association of Factors and Credit Insurers

Canadian Association of Financial Institutions in Insurance

Canadian Association of Insurance and Financial Advisors

Canadian Association of Mutual Insurance Companies

Canadian Automobile Dealers Association

Canadian Bankers' Association

Canadian Banking Ombudsman

Canadian Community Reinvestment Coalition

Canadian Corporate Funding Ltd.

Canadian Direct Marketing Association

Canadian Federation of Independent Business

Canadian Federation of Independent Deposit Brokers

Canadian Finance & Leasing Association

Canadian Fraternal Association

Canadian Imperial Bank of Commerce

Canadian Labour Congress

Canadian Life and Health Insurance Association Inc.

Canadian Life and Health Insurance Compensation Corporation

Canadian Medical Association

Canadian Payments Association

Canadian Retail Building Supply Council

Canadian Taxpayers' Federation

Canadian Vehicle Manufacturers' Association

Canadian Western Bank

Capital One Financial Corporation

Bill Casey, M.P.

Centre for Women in Business

Citizens Bank

Co-operators Group

“Coalition québécoise pour le maintien des emplois et services bancaires personnalisés”

“Commission des valeurs mobilières du Québec”

Committee on Monetary and Economic Reform

“Confédération des caisses populaires et d’économie Desjardins du Québec”

Consumers’ Association of Canada

Cordillera Books/Richmond Book Services

Council of Canadians

Credit Union Central of British Columbia

Credit Union Central of Canada

Credit Union Central of Ontario

Crozier Information Resources Consulting Ltd.

Davis Strait Fisheries Ltd.

Davis Webb Schulze & Moon

Dominion of Canada General Insurance Company

Arthur Donner

Dundee Bancorp Inc.

“École des Hautes Études Commerciales”

Edlstrom Insurance Ltd.

Ellmen / Shaw Public Affairs

Energy Consultants International Inc.

"Entraide assurance-vie, Compagnie mutuelle"

Fair Isle Ford Sales Ltd.

Farm & Garden Centre of Saskatoon Ltd.

Farm Credit Corporation

First Union Corporation

Forwell Super Variety of Waterloo Ltd.

Fox 40 International Inc.

Foxon Agencies Ltd.

Fraser Institute

Martin Freedman

GE Capital Canada

J.E.L. Gollner

Great-West Life and London Life Insurance

Guarantee Company of North America

Kelly Hague

William Henderson

HGB Associates

Hi-Alta Capital Inc.

Hongkong Bank of Canada

Manir Hossain

Hyndman & Company Ltd.

"Institut québécois de planification financière"

Insurance Brokers Association of British Columbia

Insurance Brokers Association of Canada

Insurance Brokers Association of Manitoba

Insurance Brokers Association of New Brunswick

Insurance Brokers Association of Ontario

Insurance Brokers Association of Prince Edward Island

Insurance Brokers Association of Saskatchewan

Insurance Brokers' Association of Nova Scotia

Insurance Bureau of Canada

Insurance Consumers Group

INTERAC Association

Investment Dealers Association of Canada

Islamic Financial Institutions, Canada

J. V. Laken

Kerry Financial Corporation

Laurentian Bank of Canada

Life Spin — Women's Resource Centre

London Life Policyholders' Association

Yvan Loubier, M.P.

Ian MacLeod

Manulife Financial

Maritime Association of Mutual Insurance Companies

McArthur & Company Publishing Limited

Jack McAuley

Robert McKelvy

Metropolitan Halifax Chamber of Commerce

Suzanne Meunier

Montreal Automobile Dealers Corporation

Montreal Community Loan Association

Mount Royal College

Mutual Group

National Action Committee on the Status of Women

National Anti-Poverty Organization

National Bank of Canada

National Council on Welfare

National Council of Women of Canada

National Money Mart Company

David Nopper

Norwest Financial/Trans Canada Credit

Office of the Superintendent of Financial Institutions Canada

Official Opposition of P.E.I. (Liberal Party of P.E.I.)

Kelvin Ogilvie

"Option Consommateurs"

P.E.I. Mobile Home and Trailer Sales

P.E.I. Mutual Insurance Company

Partners Inc. — Strategic Communications & Revenue Development

Peace Hills General Insurance Company

Douglas Peters, P.C.

Phonettix Intelecom

Pineridge Ford Mercury

Pixie Bigelow Productions Inc.

Portage La Prairie Mutual

Power Corporation of Canada

Primex Forest Products Ltd.

Public Interest Advocacy Centre

Quebec Association for the Protection of Savers and Investors Inc.

Claudette Racette

Ramboc Enterprises

Rankin — Stokes & Associates Inc.

Regional Group of Companies

Retail Council of Canada

Rice Financial Group Inc.

David Rosenberg

Roslyn Kunin and Associates

Royal Bank of Canada

RRSP Alliance

Self-Employment Development Initiatives

Sharwood and Company

SNC-LAVALIN Inc.

Southern Cross Sheepskins Inc.

St. Willibrord Community Credit Union

Standard Life Insurance Company

Sun Life Assurance Company of Canada

T-Base Communications Inc.

Task Force on Future of the Canadian Financial Services Sector

TelPay — A Division of CTI-Com Tel Inc.

TG International Ltd.

Dorothy Toop

Toronto-Dominion Bank

Trimark Investment Management Inc.

Trust Companies Association of Canada

John A. Turley-Ewart

"Université Sainte-Anne"

University of British Columbia

University of Ottawa

Vancouver Board of Trade

Walker Chocolate Company Ltd.

Wawanesa Mutual

Wells Fargo Bank

Mary Wilton

Women and Rural Economic Developing

World Sceptre Challenger

APPENDIX C
Members of Parliament who held Townhall Meetings on the Report of the Task Force on the Future of the Canadian Financial Services Sector

Peter Adams	*(Peterborough, Ont.)*
Jean Augustine	*(Etobicoke — Lakeshore, Ont.)*
Mauril Bélanger	*(Ottawa — Vanier, Ont.)*
Maurizio Bevilacqua	*(Vaughan — King — Aurora, Ont.)*
Bill Blaikie	*(Winnipeg — Transcona, Man.)*
Raymond Bonin	*(Nickel Belt, Ont.)*
Sarmite D. Bulte	*(Parkdale — High Park, Ont.)*
Aileen Carroll	*(Barrie — Simcoe — Bradford, Ont.)*
John Cummins	*(Delta — South Richmond, B.C.)*
Bev Desjarlais	*(Churchill, Man.)*
Gordon Earle	*(Halifax West, N.-S.)*
Derrek P. Konrad	*(Prince Albert, Sask.)*
Clifford Lincoln	*(Lac-Saint-Louis, QC)*
Steven W. Mahoney	*(Mississauga West, Ont.)*
John McKay	*(Scarborough East, Ont.)*
Ian Murray	*(Lanark — Carleton, Ont.)*
David Pratt	*(Nepean — Carleton, Ont.)*
Rahim Jaffer	*(Edmonton — Strathcona, Alta.)*
John Richardson	*(Perth — Middlesex, Ont.)*
Lou Sekora	*(Port Moody — Coquitlam — Port Coquitlam, B.C.)*
Paul Szabo	*(Mississauga South, Ont.)*
Judy Wasylycia-Leis	*(Winnipeg North Centre, Man.)*
Bryon Wilfert	*(Oak Ridges, Ont.)*

Copies of the Minutes of Proceedings (*Meetings Nos. 165 and 166*) are tabled.

Respectfully submitted,

Maurizio Bevilacqua, MP
Chair

DISSENTING OPINION OF THE OFFICIAL OPPOSITION (REFORM PARTY)

MacKay Task Force Hearings

The Official Opposition of Canada is grateful for the opportunity to present the following minority report on the Standing Committee on Finance hearings concerning the MacKay Task Force.

Overall, we believe that the findings of the MacKay Report open the door to more competition in the banking sector that will lead to substantial benefits for consumers. More competition and better service in banking is something Canadians want, need and deserve.

This is the message we also heard from the majority of witnesses. Witnesses testified that measures must be taken to enhance and increase competition in Canada's financial services industry. We therefore feel that it is incumbent upon the Liberal Government to immediately begin implementing such measures. Continued delay hurts Canadians as well as our financial services industry that must be able to prepare to meet the challenges of global competition.

Areas for increasing competition recommended by the Official Opposition include the following:

1. **Foreign Bank Entry:** The Liberal Government must end their long delay in allowing foreign bank branching. Direct foreign bank branching is the norm in most other countries.

2. **Payments System:** Opening access to all federally and provincially regulated financial institutions would: (1) End the monopoly over payments in Canada. (2) Increase financial services competition and provide a more level-playing field. (3) Moderate the increasing concentration that could arise as a result of the approval of the proposed bank mergers. (4) Increase consumer choice by allowing a wider range of financial institutions to provide payment and settlement services.

3. **Taxation:** A comprehensive review of the taxation regime encountered by Canadian financial institutions is required with the aim of improving competitiveness.

4. **Division of Powers:** Federal and provincial governments must make concerted efforts to reduce regulatory overlap and duplication to ensure equality and a cost-effective regulatory structure at every level.

Other areas of financial services regulation that the Official Opposition feels must be considered include the following:

1. **Mergers:** The Official Opposition does not believe that bank merger proposals should be arbitrarily ruled out. However, before considering the merits of any formal merger proposal, legislative changes that provide the opportunity for increased competition, from both domestic and foreign sources, must be firmly in place. In addition, the impact of mergers on rural customers must be lessened to an acceptable degree through realistic mitigation planning that must form part of any merger approval request. Finally, the potential impact of any bank mergers must be fully debated in an open forum such as Parliament.

2. **Ombudsman System:** The Canadian Banking Ombudsman must be (1) independent from the banks, (2) funded by the banks by way of fees with additional funding paid by the banks based on the number of complaints received against them, (3) able to make binding recommendations with the power of penalty enforcement, and (4) must produce an annual report to Parliament naming violators that have been assessed penalties and given binding recommendations.

3. **Insurance:** Banks should not be permitted to enter this industry in which vibrant and dynamic competition already exists. There is a consensus opinion that if banks are allowed entrance, we would very rapidly see a dominance in that industry on the part of the major banks and those few insurance companies that survive. The result would be a less competitive environment dominated by a few big players.

4. **Auto Leasing:** Maintaining the restriction on bank entrance into the auto leasing business is necessary to avoid unduly concentrating financial power in the hands of the banks. In addition, many new car dealers rely upon the banks for financing, and banks could refuse to lend to them to protect their own leasing sales.

These areas for increasing competition form a plan for increased choice and competition in the financial services sector that is based on our report, "Competition: Choice You Can Bank On."

This report is a plan that will ultimately offer Canadians better service and lower costs through more choice. It will also ensure that Canadian financial institutions are able to compete in the global marketplace, while ensuring that the services they offer will clearly remain in the best interests of Canadian consumers and business. It is a sound plan for choice and better service that is long overdue.

The Liberal Government must provide the leadership that Canadians seek and deserve. They must take action to end public concern about many aspects of our financial

services industry. The Liberal government must immediately begin the process of enacting legislation that would open the financial services industry to competition and choice and end their five-year delay.

DISSENTING OPINION OF THE BLOC QUÉBÉCOIS

The Future Starts Now: A Study on Financial Services in Canada

The Bloc Québécois is making the Liberal government retreat!

In general, the Bloc Québécois approves the Liberal majority report because it essentially embodies the positions that we have been defending since this issue first arose. It is clear that the Liberal majority has conceded most of our points.

The Bloc Québécois has always stressed that what is really at stake is not simply the question of bank mergers, but rather the future of the entire financial services industry in Quebec and Canada as it affects the public interest. It has also insisted that certain essential conditions must be met rapidly before the major banks can be allowed to merge[1]. These conditions are designed to ensure competition, protect consumers, businesses and employees in the banking sector, and accentuate the banks' social role and their democratization.

The Bloc notes that certain Liberal members of the Finance Committee changed tack, despite having signed a Liberal Caucus report categorically rejecting bank mergers. The debate now seems to be focused on what is really at stake, matters that the Bloc Québécois has been raising since the discussions began. Naturally, we are delighted.

A preliminary report ... thanks to the Bloc Québécois!

The Bloc Québécois wants to underline that this Finance Committee report is a preliminary one. Consultations based on the McKay-Ducros Report will be continuing in February and a final report will be tabled in March. Thanks to the efforts of the Bloc Québécois, a motion was tabled in the House to this effect on October 2. The Bloc was speaking on behalf of the public, which via the Coalition for Personalized Services was demanding expanded consultations so that a real debate could be held on the issue. We are pleased to have convinced the Liberals to adopt the same point of view.

Divergent opinions

The Bloc Québécois does however oppose certain of the Committee's preliminary recommendations, and plans to work on making sure that Quebec's areas of jurisdiction in the financial sector are respected. It is not necessary to centralize everything in Ottawa to achieve harmonization and simplification in the financial sector. **The Bloc is worried by**

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1 On October 26. Bloc Québécois Finance Critic Yvan Loubier tabled, on behalf of the party, a presentation to the Finance Committee that sets out our position in greater detail.

recommendations that would strip Quebec's Inspector General of Financial Institutions of his authority to monitor and regulate institutions that come under Quebec's jurisdiction by virtue of the Constitution.

The Bloc Québécois is also concerned that the Liberals are recommending that the federal government intervene in consumer protection, an area that clearly falls under provincial jurisdiction. By doing so, they will create new duplication with what already exists in Quebec. Among other things, if the federal legislation provides less protection for consumers than the Quebec legislation, there would be a weakening in the protection now enjoyed by Quebeckers. **The Bloc plans to convince the Committee that the best policy would be to give precedence to provincial consumer protection legislation where it exists, making federally chartered financial institutions subject to such legislation where necessary.**

The Bloc Québécois is disappointed that the Liberals did not see fit to propose to the Minister of Finance that he amend the legislation preventing provincial chartered insurance companies from acquiring blocks of insurance from federally chartered companies. This provision is highly prejudicial to Quebec enterprises and harmful to their development.

The Bloc Québécois dissociates itself from the Liberal majority recommendations to reduce taxes on profits made by banks and financial institutions. This measure is premature at a time when the Liberal government refuses to reduce income tax for the middle-class or to improve benefits under the employment insurance plan (which covers only two unemployed people out of five). Juxtaposing the Liberal recommendations on the banks' fiscal competitiveness with those favouring multi-millionaire athletes and high income taxpayers makes it obvious that the Liberal government is now just a government by the rich for the rich.

Lastly, the Bloc Québécois considers that the Liberals are not proposing enough measures to oblige the banks to be accountable to Quebeckers and Canadians, assume their social role and become more democratic institutions. We intend to continue our push toward these goals. It should be borne in mind that the Bloc Québécois is the only party to have tabled a Private Member's Bill on community reinvestment by the banks.

DISSENTING OPINION OF THE NEW DEMOCRATIC PARTY

The Future Starts Now

"I've seen the future, and brother, it is murder"
Leonard Cohen

"When the capital development of a country becomes a by product of the activities of a casino, the job is likely to be ill done"
J.M. Keynes

Preamble: Statement of concern over the process followed within the Standing Committee on Finance

The New Democrat members of the Standing Committee on Finance feel it is necessary to go on record and state that the process followed by this Committee must be changed in the future, and that never again a 250 page majority report be imposed to the members of the Committee without adequate time for review, debate and input from its members. In this instance the Opposition members of this Committee had effectively less than 24 hours to react to the report of the majority, on which they had no direct input. If we are to ensure that committees remain at the core of parliamentary democracy, and the public interest is upheld, then these concerns must be heeded and acted upon.

The majority report of the Standing Committee on Finance generally endorses the vision and the recommendations of the MacKay task force. One of the major exceptions is the report's opposition in allowing banks to retail insurance and automobile leasing products. New Democrats strongly support the position of the Standing Committee on Finance, regarding the restrictions on banks and life insurance companies selling insurance and automobile leasing.

The New Democrat members of the Standing Committee on Finance are pleased that the MacKay task force adopted some of the recommendations that we have been advocating for years such as: appointing an independent financial ombudsman (albeit with limited powers), enhancing the credit union system, ensuring a broader access to the Canadian Payment system and better access to basic banking services. For the Finance Committee, we are pleased to see that the majority report is urging the government to put in place a consumer protection bureau and supports the establishment of a Financial Consumers' Organisation as advocated by the Canadian Community Reinvestment Coalition. However, we believe (as was the original position in MacKay) that it may not be in the public interest for government to deny public funding to such an advocacy group.

For a decade, New Democrats have been advocating policies to protect otherwise viable small businesses against credit crunches and consumers against unjustified

interest rate spreads and service charge abuse. There is no reason for businesses to fail for artificial financial reasons.

We are pleased to see the National Liberal Task Force on the Future of The Financial Services Sector recommended policies long promoted by the NDP, such as a) upholding the "big shall not buy big" policy (and rejecting the proposed mega-bank mergers between the Royal Bank of Canada and The Bank of Montreal as well as the Toronto Dominion and The Canadian Imperial Bank of Commerce); b) introducing a Canadian Community Reinvestment Act; c) creating an Independent financial ombudsman with binding powers; d) compelling credit card issuers to calculate interest charges in a manner which fully credits any partial payment by the credit card holder and e) capping credit card interest rates. In a telling contrast, the Majority Report of the Standing Committee excluded these recommendations.

The MacKay report fails in its fundamental objective to chart a policy for the financial sector that would achieve an acceptable balance between the private interest of financial institutions and the public interest of Canadians. The following explains why the failure of both the MacKay report and the majority report is not acceptable by the NDP, and why this NDP minority report must become a document for the public record:

1) The MacKay report and the majority report are based on a narrow and short-term definition of the public good that amounts to nothing more than the sum of private interest which would prevail at the expense of the public interest. It is dangerously simplistic to assume that a deregulated open financial system will somehow magically support the public interest. The global financial crisis and the inability of financial authorities to contain it demonstrate that there is simply no evidence that a deregulated financial system is efficient, especially in the long run, or that globalised finance will be stable. A number of international banks have either collapsed or are being rescued at great cost by taxpayers. Aggressive speculators extort exorbitant profits at the expense of the poor by pitting country against country, company against company and community against community in a merciless race to the bottom.

Close regulation of financial institutions and the dismantling of the global casino are required as well as the need to redefine how we measure and create wealth. Our ability for unprecedented wealth creation stands in sharp contrast with the reality of fewer people benefiting from this capacity, as well as the collapse of global demand because of shrinking purchasing power. In Canada, the effects are already felt through the collapse of commodity prices and the worst farm crisis since the Great Depression. The current chaos is largely created by the deregulation of global finance, the quest for fiscal surpluses and speculative greed. We need a new economic vision for the 21st Century, one based on increasing real wealth and reducing inequality.

A New Democrat vision for Canada's financial system emphasizes a much broader definition of the public good, one that includes, as core elements, **full employment** and cooperation between: trade unions, small and large businesses, community organisations, government, the financial sector, and, most importantly, a proactive role for

the Bank of Canada. A social democratic perspective must go beyond the traditional image of the financial corporation and requires financial institutions have broader responsibilities than just to their shareholders. These responsibilities are commensurate with the vast powers and privileges granted to financial institutions by the public through Parliament. Financial regulation must therefore foster a commitment by chartered financial institutions to the public good, to the communities they serve and the country which supports them.

2) Regrettably, the MacKay report and the majority report recommend more deregulation; this will only amplify the strategy of financial institutions which have sought to take advantage of deregulation to maximize their earnings by financing massive speculative investments.

As financial institutions continue to fail, to cite the American experience, more and more U.S. politicians and bankers recognize existing mechanisms of control cannot cope. Meanwhile, it is disturbing to see that the total exposure of the big five Canadian chartered banks to risk in the ailing Asian markets exceeds $40 billion - or more than 100% of their combined capital. The Canadian government must recognize the pressing need for re-regulation. Regulators must deal with recent destabilizing financial innovations (see parts 4&12). The task force has not researched this crucial issue.

3) Neither MacKay nor the majority report deal properly with the crucial role of banks. The NDP rejects the notion that banks are just a special class of financial intermediaries. Banks are at the core of our economic system. If we cannot regulate banks properly, we lose financial and ultimately our political sovereignty. Banks decide which firms survive and which ones fail; which jobs are created and which jobs are destroyed; who gets a home and who does not. Simply put, banks are not ordinary corporations. The banking sector does much more than just lend deposits. Banking institutions create money by granting loans to firms, consumers or governments. Banks also create money through indirect means such as securitization and off-balance sheet activities. Banks are therefore not merely intermediaries. In the US, for instance, this reality is reflected by the Community Reinvestment Act (CRA), which creates a framework of accountability between banks and their communities. The Majority report is opposed to the principle of a CRA. In fact, the majority report moves further away from the notion of accountability by recommending that Community Accountability Statements, as proposed by MacKay, not be required from financial institutions. New Democrats believe it is essential that Parliament should empower an all party committee to conduct a full inquiry into the US community reinvestment system, and into its impact on job creation, affordable housing, and community development.

4) Both reports also ignore the central role of the Bank of Canada and its relation to the chartered banks. In Canada, the creation of money has been mostly privatized since the end of WWII. An effective monetary policy must not only address central banking policy, it must also regulate the role of private banks in the creation of money. By requiring banks to hold up to 100 % of the value of a category of loans in reserve, the Bank of Canada could influence lending selectively. Selective requirements on loans must be part of the

monetary policy tool box in the 1990s, such as imposing 100% reserve requirement on loans which are not targeting the direct creation of wealth, productive investments and payment of salaries and wages (for instance, a 0% reserve could be required for lending that supports job creation, community reinvestment, or the redevelopment of polluted lands). As former Prime Minister Mackenzie King warned *"Once a nation parts with the control of its currency and credit it matters not who makes the nation's laws... Until the control of the issue of currency and credit is restored to government and recognized as its most conspicuous and sacred responsibility, all talk of the sovereignty of parliament and of democracy is idle and futile."*

5) Both reports embrace a purely micro-economic vision of the financial sector, which is the perspective of the CEO/manager. The reports substitute this narrow vision for a public interest perspective. This is particularly dangerous in a world where bankers who once prided themselves for prudence and due diligence now talk about their desire to "kick global ass."

6) In correlating the increase in earnings by Canadian chartered banks to the globalization of their services, MacKay ignores the fact that the bulk of the growth in bank profits originates from their domestic market power. This power allows banks to slap service charges across a vast and complex continuum of financial services, while engaging in highly profitable speculative activities through their securities affiliates. Because Canadian banks will strive to reach the same rates of return that large foreign banks achieve in speculative markets, Canadian bankers will in the end expect much higher rates of return on productive domestic operations. The globalization of banking leads to Canadian banks substituting speculative loans for productive lending to the domestic economy.

7) Both reports recommend relaxing the 10% ownership rule, which has worked successfully to uphold the public interest by preventing Canadian chartered banks from being controlled by foreign interests or dominated by owners who would use the bank to further their own interests (the 10% rule was put into place in the 1960s when the Chase Manhattan of New-York wanted to buy the Toronto Dominion Bank). This recommendation means the abandonment of the provision of domestic credit to financial institutions which will no longer have a preferred relationship with the Canadian domestic economy. Foreign financial institutions such as Wells Fargo and ING are only interested in skimming off the best customers and make it more difficult for Canadian financial institutions to serve all Canadians. In the long run, foreign financial multinationals operating in Canada will impose their profit margins on the Canadian consumer, and banks operating in Canada will lend to the Canadian public only if they can attain the same earnings that they achieve in their highly profitable and mainly international operations. And worse, they will impose compensation on the Canadian public for their losses as they have in the past.

8) Both reports abandon the "big shall not buy big policy" and therefore implicitly encourage mega-bank mergers. The reports state that mergers should be accepted as long as the Minister of Finance believes them to be in the public interest. Making this distinction is quite impossible because according to these reports, one of the main factors

defining the public interest is the future enhancement of competitiveness in the global economy. And what exactly does that mean? Banks can always demonstrate merging will reinforce their competitiveness relative to their global competitors. By concentrating more powers in the hands of the Minister of Finance, MacKay further limits opportunities for parliamentary and democratic input on these issues which strongly affects the public interest.

9) The reports implicitly advocates a complete integration of the Canadian financial system to the global U.S. financial system. Again, this recommendation ignores the evidence of the distinctiveness of the financial industry. A complete integration would lead to the loss of control over our monetary policy and to the loss of Canada's sovereignty.

10) The reports do not address the consequences of systemic failures which may be triggered by the collapse of merged banks. In an unstable financial economy large banks can be much more exposed to risk than smaller ones and the larger they are, the higher the fall and the lower the capacity of government to let banks fail. For instance, clause 39 of the recommendations authorizes the Minister of Finance to sell off a Canadian chartered bank to foreign interests in "exceptional cases", and as long the sale conforms to the public interest. Mr. MacKay himself stated before the Finance Committee that the purpose of recommendation 39 was to give the Minister of finance a lower-cost solution for dealing with a mega-bank failure. Assuming the failure of a mega-bank in Canada because of losses in speculative markets (as happened in Japan recently), means there will be no domestic financial institutions large enough left to buy out the mega-bank. To have the costs underwritten by the Canadian taxpayer will be far too much of a burden. According to MacKay, then, the solution would be to sell the mega-bank to foreign buyers. In the long run, these mega-mergers could quite possibly accelerate the sell-out of our banking system to foreign interests.

11) The MacKay report only briefly talks about regulations and corporate governance. Canadians should be particularly concerned by the explosive growth in derivative products and off-balance sheet liabilities. Derivative products are very risky and the leading cause of the current banking failures. Like all pyramid-like schemes, these financial products are not supported by real economic activity and have resulted in the failure of trillions and trillions of dollars of highly leveraged contracts. Derivative products, which can bring down a large bank (i.e.Barings), are used primarily for speculative purposes instead of for hedging risk, which is their theoretical rationale. These huge losses then bounce back to all parties involved and ultimately impact on the real economy. Economic theory and regulations have not caught up with this huge and fast growing market and no one, not even the U.S. Federal Reserve, truly understands the potential of the disaster. It is interesting to note that Robert Merton and Myron Scholes who both won the Nobel Prize for their theoretical work on derivatives had to take responsibility for the collapse of the Long Term Capital Management, a hedge fund that lost its equity and had to be bailed out. It is frightening that the majority report has not taken into account the new dangers involved in derivatives and the inadequacy of self regulation in preventing huge losses which would have to be directly or indirectly underwritten by the public.

12) To control derivatives or to mitigate the effects of a spillover, the powers of the Office of the Superintendent for Financial Institutions (OSFI) should be extended. The reports should have recommended the creation of financial structures and rules that would make the work of the Superintendent effective in an age of ever-increasing complexity. The Auditor-General has written about "the capacity of the Office of the Superintendent of Financial Institutions to evaluate credit risks facing the banks from derivatives and securities activities." (Globe and Mail May 12, 1995, p. B1). These financial liabilities and the risk they carry must be brought back to formal accounting rules with adequate regulation and supervision. Today's accounting rules for derivatives and other similar financial operations leave regulators and investors largely in the dark. We should look into new ways of accounting which would integrate off balance sheet risk into the balance sheet. This is an issue which the two reports do not explore. The preferred option for the NDP would be to directly or indirectly prohibit the financing of derivative operations through bank credits.

Instead, the reports recommend that financial institutions be given maximum organizational flexibility, including the ability to set up sophisticated Financial Holding Companies (FHCs) with relaxed ownership rules, and "as non-intrusive as possible" regulatory requirements.

In a de-regulated global environment, these financial groups would make the job of the regulator impossible. Global FHCs will be extremely difficult to supervise and will be prone to tax avoidance. However, with adequate regulation, and provisions guaranteeing that the headquarters of both parents and subsidiaries remain in Canada, the FHC may open an avenue to segregate and contain higher risk activities such as derivatives from normal risk core banking activities. At a national level, the FHC structure could be used to combine innovative regulations which target speculation (such as selective reserve requirements), with functional regulation. Functional regulation would isolate speculative activities from core banking activities. This may help prevent speculative firestorms and somehow contain contagion while protecting depositors (and taxpayers). For instance, should a chartered bank be involved in a massive derivative meltdown, the damage would be confined to its securities affiliate. At best, the FHC system should be considered as a vehicle for more transparency and re-regulation and not for de-regulation as the report advocates.

In sum, the MacKay report favours the integration of the Canadian financial system to a costly and chaotic model of financial globalisation at a time where many are searching for a more equitable alternative model. Regrettably, the MacKay report and the $3.5 million spent on it provide little guidance for a banking system that must promote stability and serve all Canadians fairly in the new millennium.

HON. LORNE NYSTROM,
M.P. — REGINA — QU'APPELLE
NDP CRITIC FOR FINANCIAL INSTITUTIONS

DISSENTING OPINION OF THE PROGRESSIVE CONSERVATIVE PARTY

Response to *Change, Challenge, Opportunity* — Report of the Task Force on the Future of the Canadian Financial Services Sector: The Challenge is to Implement Changes that Provide Canadians with Real Opportunity

INTRODUCTION

The Report of the (MacKay) Task Force on the Future of the Canadian Financial Services Sector contains some very broad and far-reaching recommendations, covering the interests and concerns of consumers to the corporate structure of financial institutions.

The MacKay Report provided a legitimate framework for meaningful discussions on the nature and structure of the financial services industry in Canada. The PC Party has been advocating and implementing change in this sector for many years. Our Party brought in reforms that saw cross-pillar activities by financial institutions. These changes have given consumers greater choice, and Canada more innovative, efficient, and stronger financial institutions.

The PC Party agrees with the overall theme of the MacKay Report: Canadian consumers are best served by a dynamic and competitive marketplace. To achieve the goal of a more competitive and innovative marketplace, we believe the following recommendations should be adopted by the federal government.

RECOMMENDATIONS

Increasing Competition/Choice for Canadians

- The Progressive Conservative Party supports the MacKay Task Force recommendations to encourage start-ups of new Canadian financial institutions. These initiatives will help create an environment in which innovation will flourish and consumers will be provided with new products and services.
- We support the MacKay Report recommendation that would permit the Minister of Finance to have discretion to allow new financial institutions (including banks) to incorporate with less than $10 million in capital.
- The Task Force recommendation for a 10-year capital tax exemption for new financial institutions should be implemented.

- We endorse the MacKay recommendation to increase foreign competition to ensure that consumers have the most choice possible for their financial services.
- We support the elimination of withholding taxes for all arm's-length borrowing. These taxes discriminate against foreign lenders, and reduce access to capital for Canadians.
- We support levelling the playing field between all financial services companies by allowing non-bank firms access to the Canadian Payments Association.
- The PC Party supports the recommendations to reduce the regulatory burden on the Cooperative sector (Credit Unions) to encourage greater competition and choice for Canadians.
- The Interac network should be fully utilized to permit as many functions as the technology allows, including making deposits through any ATM to any participating deposit-taking institution.

Regulation

- The PC Party endorses the concept of reducing duplication of regulation between federal and provincial regulatory bodies. We are encouraged by the latest cooperative initiative by the provincial securities commissions.
- We support the reduction of the regulatory burden for financial institutions, while ensuring the financial services industry is prudentially safe and sound.

Consumer Powers

- We support the MacKay Report recommendations on transparency, privacy, and consumer redress.
- We agree with the MacKay report recommendation that there should be a specific legislative ban on coercive tied-selling by all financial institutions.

Retailing Insurance and Light Vehicles Leasing

- The PC Party does not endorse the Task Force recommendation to allow banks to sell insurance through their branches. We would, however, encourage further investigation into the potential effects of allowing deposit-taking institutions to retail insurance, certainly as the regulatory and competitive environment improves and if the government moves to increase consumer protection.
- The PC Party does not support the Task Force recommendation to allow banks to lease light vehicles through the branch network. An alternative may be for the banks to lease light vehicles through automobile dealers.

Bank Mergers

The Progressive Conservative Party of Canada understands the rationale for, and acknowledges the potential of such mergers to create strong financial institutions that are able to compete in both international and domestic markets.

Given that the Competition Bureau has not reported its findings and that Canadians have not been given a chance to speak on this issue, the PC Party cannot endorse or oppose the proposed mergers between the Royal Bank of Canada and the Bank of Montreal, and between the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank. We must have more and better information than that which is available now.

Given the lack of complete analysis, it is interesting to note that the Liberal Caucus Committee on Financial Services has already made a decision on the proposed bank mergers. Like the APEC Inquiry and the Somalia Affair, the Liberals have prejudged the merger process, putting partisan politics ahead of public policy.

It would be inappropriate for the Finance Minister to make his decision on the proposed bank mergers immediately after he receives the Competition Bureau Report which is due to be released December 1998. The final report of the Finance Committee on the Future of Canadian Financial Services is not to be tabled in the House of Commons until March 1999.

The PC Party proposes a review mechanism expanded beyond the Public Interest Review Process (PIRP) set out in the MacKay Report. The public review will fully examine the impact the proposed mergers will have on Canadians and our financial services industry and would be conducted under the direction of the Finance Department.

Under the PC Party's Proposal for a Public Interest Review Process:

- Public hearings would be held across Canada for a period of 90 days. The travelling hearings would be broad consultations on the specific mergers being proposed.

- The review guidelines should require merger proponents to submit a detailed Public Interest Impact Assessment that:

  1) describes their business plan and objectives if the mergers are approved, and an alternative business plan in the event that the mergers are not approved;

  2) clearly identifies the benefits and costs to the nation and the public;

  3) outlines any remedial steps with respect to public interest costs, and any assurances with respect to public interest benefits, which are proposed by the merger proponents.

  4) addresses public concerns, including:

(i) job losses due to mergers and how institutions deal with potential job losses (i.e., through early retirement, buy-out packages, etc.);

(ii) small business lending and the availability of capital to small and medium-sized businesses;

(iii) rural access to financial services;

(iv) bank service charges and how savings resulting from mergers will be shared with consumers.

- The Finance Committee should receive a summary of the presentations heard under the PIRP and should table its report in the House of Commons within 60 days of receiving the summary of the hearings.

- Members of Parliament should debate the Finance Committee report and the report of the presentations made at the public hearings.

- Within 30 days of the tabling of the Finance Committee report in the House of Commons and after debate by Members of Parliament, the Finance Minister would announce his decision.

The Minister of Finance should have legislative authority to seek and obtain enforceable undertakings from the merging banks to ensure that commitments made to address competition and other public interest concerns are fulfilled. Strong legal sanctions should be provided for non-compliance with the commitments.

MINUTES OF PROCEEDINGS

MONDAY, DECEMBER 7, 1998
(*Meeting No. 165*)

The Standing Committee on Finance met *in camera* at 11:20 a.m. this day, in Room 371, West Block, the Chair, Maurizio Bevilacqua, presiding.

Members of the Committee present: Carolyn Bennett, Maurizio Bevilacqua, Scott Brison, Ken Epp, Roger Gallaway, Dick Harris, Yvan Loubier, Gary Pillitteri, Karen Redman and Paul Szabo.

Acting Members present: Serge Cardin for Odina Desrochers; Hec Clouthier for Nick Discepola; George Baker for Sophia Leung; the Hon. Lorne Nystrom for Nelson Riis; Carmen Provenzano for Tony Valeri.

In attendance: From the Library of Parliament: Richard Domingue, Research Officer and Marion Wrobel, Senior Analyst.

In accordance with its mandate under Standing Order 108(2), the Committee began the consideration of its draft report on the Future of the Canadian Financial Services Sector.

It was agreed, — That a note be printed on the first page of the 12th Report of the Standing Committee on Finance, reflecting an agreement made in the House of Commons on October 2, 1998, that a preliminary report be tabled in December 1998 and that a final report be tabled in March 1999.

It was moved, — That the cover page reflect the preliminary aspect of the Mackay Report and that the content be consistent with the motion adopted by unanimous consent on October 2, 1998.

The question being put on the motion. It was negatived.

It was agreed, — That the cover page of the report be identical to the cover page of the Pre-Budget Consultations Report but without the words Report of the Standing Committee on Finance.

It was agreed, — That the draft Report, be adopted as the Committee's Twelfth Report to the House and that the Chairman be instructed to present it to the House.

It was agreed, — That the title of the Twelfth report be as follows: The Future Starts Now. A study of the Financial Services Sector in Canada.

It was agreed, — That the Committee print 3,000 copies of its Twelfth Report in English and 750 copies in French with a distinctive cover.

It was agreed, — That the Committee authorize the printing of the dissenting opinions of the opposition parties, and that they be submitted to the Clerk's office no later than December 9th at 5:00 p.m.

It was agreed, — That the Chairman, researchers and clerks be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the report.

It was agreed, — That members of the Standing Committee on Finance solemnly promise on their honour not to disclose or comment on the content of the Committee Report on the Future of the Canadian Financial Services Sector or on any dissenting opinions included in the Report before the Report is tabled in the House.

At 1:25 p.m., the Committee adjourned to the call of the Chair.

Lahaie Roxanne Enman

Jacques Lahaie and Roxanne Enman
Clerks of the Committee

TUESDAY, DECEMBER 8, 1998
(*Meeting No. 166*)

The Standing Committee on Finance met at 3:35 p.m. this day, in Room 371, West Block, the Chair, Maurizio Bevilacqua, presiding.

Members of the Committee present: Carolyn Bennett, Maurizio Bevilacqua, Scott Brison, Odina Desrochers, Nick Discepola, Ken Epp, Roger Gallaway, Dick Harris, Gary Pillitteri, Karen Redman, Paul Szabo and Tony Valeri.

Acting Member present: Paddy Torsney for Sophia Leung.

Associate Member present: The Hon. Lorne Nystrom.

In attendance: From the Library of Parliament: Marion Wrobel, Senior Analyst. *From Committees and Legislative Services Directorate:* Richard Dupuis, Legislative Clerk.

Appearing: From the Department of Finance: The Hon. Jim Peterson, Secretary of State (International Financial Institutions).

Witnesses: From the Department of Finance: Charles Seeto, Director, Financial Sector Division; Claude Gingras, Special Advisor, Financial Sector Division. *From the Office of the Superintendent of Financial Institutions Canada:* Michael Hale, Director, Acutarial.

The Order of Reference being read as follows:

ORDERED, — That pursuant to Standing Order 73(1), Bill C-59 — An Act to Amend the Insurance Companies Act, be referred to the Standing Committee on Finance forthwith and without debate.

On Clause 1

The Honourable Jim Peterson made a statement and with Claude Gingras, Charles Seeto and Michael Hale, answered questions.

At 4:40 p.m.

By unanimous consent, it was agreed — That notwithstanding the Committee's decision of December 7, 1998, the name of the Standing committee on Finance be printed on the cover page of the Twelfth Report.

Odina Desrochers moved, — That the Standing Committee condemn the following members: Scott Brison (Kings—Hants) and Gary Pillitteri (Niagara Falls) for contempt of the Finance Committee.

After debate, the motion was withdrawn.

At 4:55 p.m., the Committee adjourned to the call of the Chair.

Christine Fisher and Roxanne Enman
Clerks of the Committee